DISTRIBUTION AND ECONOMICS OF EMPLOYER-PROVIDED FRINGE BENEFITS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY AND
SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

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DISTRIBUTION AND ECONOMICS OF EMPLOYER-PROVIDED FRINGE BENEFITS

MONDAY, SEPTEMBER 17, 1984

HOUSE OF REPRESENTATIVES, COMMITTEE ON WAYS AND MEANS, SUBCOMMITTEE ON SOCIAL SECURITY, AND SUBCOMMITTEE ON SELECT REVENUE MEASURES,
Washington, DC.

The subcommittees met at 10:05 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the Subcommittee on Social Security) and Hon. Fortney H. (Pete) Stark (chairman of the Subcommittee on Select Revenue Measures) presiding.

[The press release announcing the hearing and background information follow:]

[Press release No. 10, Wednesday, August 29, 1984]

THE HONORABLE J.J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON SOCIAL SECURITY, AND THE HONORABLE FORTNEY H. (PETE) STARK (D., CALIF.), CHAIRMAN, SUBCOMMITTEE ON SELECT REVENUE MEASURES, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCE A HEARING TO GATHER GENERAL INFORMATION ON THE DISTRIBUTION AND ECONOMICS OF EMPLOYER PROVIDED FRINGE BENEFITS

The Honorable J.J. Pickle (D., Texas), Chairman of the Subcommittee on Social Security, and the Honorable Fortney H. (Pete) Stark (D., Calif.), Chairman of the Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, today announced a joint oversight hearing on the distribution and economics of employer provided fringe benefits.

The hearing will be held on Monday, September 17, 1984, and Tuesday, September 18, 1984, in the Committee's main hearing room, 1100 Longworth House Office Building, beginning at 11:00 a.m. Testimony will be received from invited witnesses representing the Administration, plan providers, employee and management organizations, and invited public witnesses.

In announcing the hearing, Chairman J.J. Pickle stated: "The subcommittees do not have a legislative proposal before them and these hearings are not designed to draft any particular legislative proposal. Rather these hearings are designed to gather information and better inform the Congress and the public about certain aspects of fringe benefits. First of all, the subcommittees are interested in determining the prevalence of fringe benefits in the working population in general and among different types of workers in particular. Secondly, the subcommittees will be exploring the economics of fringe benefits and will be interested in learning how employers and employees consider the tax status of various fringes in devising a total compensation package. The economic effects of these decisions will also be of interest."

Chairman Stark noted, "Last year the Select Revenue Measures Subcommittee reported out legislation (now part of P.L. 98-369) that codified long-established nonstatutory fringe benefits, but subjected all benefits not expressly exempted to tax. Now that we have eliminated the distinction between statutory and nonstatutory benefits, it is time to examine on a comprehensive basis all benefits exempted from tax currently in the Code. We need to understand their true cost, both in terms of lost revenue and in terms of higher taxes paid on nonexempt forms of compensation. While no one doubts that fringe benefits serve many useful social purposes, we in the Congress do not have a clear understanding of the true cost of these exemptions."

FRAMEWORK FOR HEARINGS

While recognizing that the subject of fringe benefits is diverse and complex the subcommittees are particularly interested in receiving testimony on the following:

(1) How prevalent are the available fringe benefits. Specifically, what percent of the work force is covered by the various fringe benefits, such as pensions, and what percent of compensation do fringe benefits represent? How does this compare with their historic availability and utilization, and what changes are currently projected to occur in the future?

(2) Which employees by salary range and occupation receive the various fringe benefits?

(3) Since different types of fringe benefits are subject to different tax treatment, how do employers and employees decide to structure a total compensation package which includes cash, taxable fringe and nontaxable fringe? What is the effect of tax-favored treatment on the selection of certain fringe benefits in comparison to other fringe benefits and cash remuneration? What would be the effect of the availability and use of various fringe benefits if the favorable tax treatment were changed, for instance, if FICA tax were imposed?

(4) What are the economic effects of the utilization of fringe benefits? What is the effect of the tax-favored treatment of certain fringe benefits on the horizontal and vertical equity of the income tax system? For example, for any given level of overall federal revenue, would the incidence of the income tax shift significantly if currently nontaxable fringe benefits were subject to income taxes?

(5) How much could FICA tax rates be lowered if nontaxable benefits were included in the social security wage base? What is the effect of the exclusion of certain fringe benefits from the social security wage base on social security benefits received by various types of workers?

(6) What would be the effect of placing a fixed dollar cap, flat excise tax, or a limit on the percent of compensation which could be accorded tax-exempt or tax-deferred treatment? What levels or limits would be necessary in order to prevent further erosion of tax bases?

(7) What is the relationship between fringe benefits provided by employers and social programs provided by government agencies? What social purposes are served by various fringes? If certain fringe benefits were not provided by employers, would there be an increased dependency on existing federally funded social programs or a need to create federally funded social programs? Which is the most efficient use of resources in providing specific services or benefits: encouraging employers to provide them through perferred tax treatment or providing them through directly funded public programs?

WRITTEN STATEMENTS FOR THE RECORD OF THE HEARING

Testimony will be received from invited witnesses only. All other interested parties wishing to submit written statements for the record of the hearing are encouraged to do so. Persons submitting written statements should submit at least six (6) copies by the close of business Friday, September 21, 1984, to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the hearing wish to have their statements distributed to the press and the interested public, they may provide 100 additional copies for this purpose to the Committee office, 1102 Longworth Building, before the hearing begins.

[JOINT COMMITTEE PRINT]

OVERVIEW OF THE TAX TREATMENT OF FRINGE BENEFITS

SCHEDULED FOR JOINT HEARINGS

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

AND THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

ON

SEPTEMBER 17 AND 18, 1984

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

SEPTEMBER 14, 1984

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INTRODUCTION

The Subcommittee on Social Security and the Subcommittee on Select Revenue Measures of the Committee on Ways and Means have scheduled joint public hearings on September 17 and 18, 1984, on the Federal tax treatment of fringe benefits.

In the press release announcing the oversight hearing, Chairman Pickle of the Social Security Subcommittee stated that "the subcommittees do not have a legislative proposal before them and these hearings are not designed to draft any particular legislative proposal. Rather, these hearings are designed to gather information and better inform the Congress and the public about certain aspects of fringe benefits. First of all, the subcommittees are interested in determining the prevalence of fringe benefits in the working population in general and among different types of workers in particular. Secondly, the subcommittees will be exploring the economics of fringe benefits and will be interested in learning how employers and employees consider the tax status of various fringes in devising a total compensation package. The economic effects of these decisions will also be of interest."

Chairman Stark stated that "last year the Select Revenue Measures Subcommittee reported out legislation (now part of P.L. 98-369) that codified long-established nonstatutory fringe benefits, but subjected all benefits not expressly exempted to tax. Now that we have eliminated the distinction between statutory and nonstatutory benefits, it is time to examine on a comprehensive basis all benefits exempted from tax currently in the Code. We need to understand their true cost, both in terms of lost revenue and in terms of higher taxes paid on nonexempt forms of compensation. While no one doubts that fringe benefits serve many useful social purposes, we in the Congress do not have a clear understanding of the true cost of these exemptions."

The first part of the pamphlet is a summary. This is followed by a more detailed overview of the Federal tax treatment of fringe benefits, including qualified pension, profit-sharing, or stock bonus plans, qualified annuity plans, and tax-sheltered annuities. The final part sets forth background information, including revenue implications of the tax treatment of certain fringe benefits and growth in certain fringe benefits.

I. SUMMARY

In general

The Code defines gross income for purposes of the income tax and the tax on self-employment income (SECA) as including "all income from whatever source derived" and specifies that it includes "compensation for services" (sec. 61). Similarly, the social security and unemployment insurance payroll taxes (FICA and FUTA) and income tax withholding generally apply to all remuneration for employment, including noncash remuneration. Any fringe benefit that does not qualify for exclusion under a specific statutory provision is includible in gross income, and subject to employment taxes, at the excess of its fair market value over any amount paid by the employee for the benefit.

Statutory fringe benefit provisions

As a general rule, if an employer-provided fringe benefit program qualifies under a specific statutory provision of the Code, then the benefits provided under the program are excludable (generally, subject to dollar or other limitations) from the employee's gross income for income tax purposes. The costs of benefits that are excluded from an employee's income nonetheless are deductible by the employer provided they constitute ordinary and necessary business expenses. The income tax exclusions also generally apply for payroll tax purposes.

The Code provides specific exclusions, among others, with respect to employer provision of (1) up to $50,000 of group-term life insurance; (2) up to $5,000 of death benefits; (3) accident or health benefits; (4) parsonage allowances; (5) certain benefits provided to members of the Armed Services; (6) meals and lodging for the convenience of the employer; (7) group legal services; (8) commuting through use of a van pool; and (9) dependent care assistance.

Miscellaneous fringe benefits

The Economic Recovery Tax Act of 1981 (P.L. 97-34) extended through December 31, 1983, a moratorium on the issuance of Treasury regulations relating to the income tax treatment of nonstatutory fringe benefits. The Treasury Department has announced that the Treasury and the IRS "will not issue any regulations or rulings altering the tax treatment of nonstatutory fringe benefits prior to January 1, 1985," and that "present administrative practice will not be changed during this period" (Ann. 84-5, 1984-4 I.R.B. 31).

Under the Tax Reform Act of 1984 (P.L. 98-369), certain miscellaneous fringe benefits provided by an employer are excluded from the recipient employee's gross income for Federal income tax purposes and from the wage and benefit bases for purposes of social security and other employment taxes. The excluded fringe benefits are those that qualify under one of the following five categories as defined in the Act: (1) a no-additional-cost service, (2) a qualified employee discount, (3) a working condition fringe, (4) a de minimis fringe, or (5) a qualified tuition reduction. Special rules apply with respect to certain parking or eating facilities provided to employees and certain on-premises athletic facilities.

In the case of a no-additional-cost service, a qualified employee discount, a subsidized eating facility, or a qualified tuition reduction, the exclusion applies with respect to benefits provided to officers, owners, or highly compensated employees only if the benefits are also made available to other employees on a nondiscriminatory basis.

The provisions of the Act generally take effect on January 1, 1985, except that the tuition reduction exclusion applies with respect to education furnished after June 30, 1985.[1]

Benefits provided under a cafeteria plan

Under a cafeteria plan, a participant is offered a choice between cash and certain fringe benefits. Under the law in effect prior to the Tax Reform Act of 1984, a participant in a cafeteria plan could choose among cash, any taxable benefits (such as use of an employer-provided vacation facility), and nontaxable benefits (such as coverage under an accident and health plan). If the plan meets certain conditions generally related to nondiscrimination in favor of highly compensated employees, the participant is not treated as having received cash or a taxable fringe benefit solely because the participant has the opportunity, before the benefit becomes available to the participant, to choose among the taxable and nontaxable benefits offered under the plan.

On February 10, 1984, the IRS issued a news release (IR-84-22) stating that so-called "flexible spending arrangements" offered as part of a cafeteria plan did not provide employees with nontaxable benefits under the Code because, under such arrangements, employees are assured of receiving the benefit of what they would have received had no covered expenses been incurred. In May, 1984, the IRS issued proposed regulations with respect to the cafeteria plan rules and the statutory rules governing the exclusion of benefits from gross income.

The Tax Reform Act of 1984 limits an individual's choices under a cafeteria plan to cash and fringe benefits that are excludable under a specific provision of the Code (other than scholarships or fellowships, van pooling, and those benefits excludable under the miscellaneous fringe benefit provisions of the Act). The Act also amends the cafeteria plan rules to provide that if, for a plan year, more than 25 percent of the total nontaxable benefits are provided to key employees, the key employees are taxed as if they received all available cash and taxable benefits under the plan. The Act imposes certain reporting requirements on employers maintaining cafeteria plans.

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[1] Also, the Act imposes a moratorium, with respect to lodging furnished after December 31, 1983, and before January 1, 1986, on the issuance of income tax regulations providing for the inclusion in gross income of qualified campus lodging.

The cafeteria plan provisions of the Act are effective on January 1, 1985. In addition, the Act provides transition relief from the application of some requirements of the proposed regulations up to January 1, 1985, or, in some cases, July 1, 1985.

Welfare benefit plans

The Tax Reform Act of 1984 modified the tax treatment of employers with respect to certain benefits provided to employees under a welfare benefit plan. Under the Act, deductions for contributions to a welfare benefit fund are limited to qualified costs. Qualified costs generally consist of (1) qualified direct costs and (2) additions, within limits, to a qualified asset account. In general, the qualified asset account limit is the amount estimated to be necessary under actuarial assumptions, which are reasonable in the aggregate, to fund the liabilities of the plan for the amount of claims incurred but unpaid to provide certain benefits and the administrative costs of such benefits. In addition, the Act provides that the qualified asset account may include, within limits, amounts reasonably necessary to accumulate reserves on a level annual basis under a welfare benefit plan so that a medical benefit or life insurance benefit (including a death benefit) payable to or on behalf of a retired employee is fully funded upon retirement.

The Act modifies the rules relating to the unrelated business taxable income of certain tax-exempt organizations that provide employee benefits, and establishes new nondiscrimination standards for these organizations.

These provisions of the Act generally are effective for contributions paid or accrued after December 31, 1985. A special effective date is applied to plans maintained pursuant to a collective bargaining agreement in effect on July 1, 1985. In addition, the Act provides certain transition rules with respect to existing reserves. The provisions of the Act relating to nondiscrimination requirements apply to taxable years beginning after December 31, 1984.

Qualified pension, profit-sharing, and stock bonus plans

If a pension, profit-sharing, or stock bonus plan qualifies under the tax law, then (1) a trust under the plan is generally exempt from income tax, (2) employers are generally allowed deductions (within limits) for plan contributions for the year for which the contributions are made, even though participants are not taxed on plan benefits until the benefits are distributed, (3) benefits distributed as a lump sum distribution may be accorded special long-term capital gain treatment or 10-year income averaging treatment, or may be rolled over, tax-free, to an individual retirement account or annuity (IRA) or another qualified plan, and (4) certain partial distributions may be rolled over, tax-free, to an IRA. Special rules are provided for tax-sheltered annuity contracts and simplified employee pensions.

II. DESCRIPTION OF TAX TREATMENT OF FRINGE BENEFITS

A. Statutory Fringe Benefit Provisions

In general

Gross income, for income tax purposes, includes "all income from whatever source derived" (Code sec. 61(a)). This provision "is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected" (*Comm'r* v. *Smith*, 324 U.S. 177, 181 (1945)).

The social security and unemployment insurance payroll taxes (FICA and FUTA, respectively) and income tax withholding apply to "wages," defined in the statutes as all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash (secs. 3121(a), 3306(b) and 3401(a)). The railroad retirement tax (RRTA) applies to any form of money remuneration (sec. 3231(e)). Regulations applicable to these statutes specify that the value of any noncash item is to be determined by the excess of its fair market value over any amount paid by the recipient for the item (see, e.g., Reg. sec. 31.3121(a)-1(e)).

As a general rule, if an employer-provided fringe benefit program qualifies under a specific statutory provision of Federal income tax law, then the benefits provided under the program are excludable (generally, subject to dollar or other limitations) from the employee's gross income for income tax purposes. Similar exclusions also generally apply for employment tax purposes. The costs of benefits that are excluded from the employee's income nonetheless are deductible by the employer, provided they constitute ordinary and necessary business expenses (Code sec. 162).

The social security tax on self-employment income under the Self-Employment Contributions Act (SECA) applies to net earnings from self-employment defined generally as gross income from an individual's trade or business, less the deductions allowed under the income tax which are attributable to the trade or business. Thus, the fringe benefits excluded from income of self-employed individuals under the income tax generally also are excluded from the base of the self-employment tax.

The Internal Revenue Code provides specific income tax exclusions, among others, with respect to employer-provided benefits of (1) up to $50,000 of group-term life insurance; (2) up to $5,000 of death benefits; (3) accident or health benefits; (4) parsonage allowances; (5) certain benefits provided to members of the Armed Services; (6) meals and lodging for the convenience of the employer; (7) legal services; (8) commuting through use of a van pool; and (9) dependent care assistance. These fringe benefits have commonly been referred to as statutory fringe benefits.

In addition, the Tax Reform Act of 1984 provided statutory exclusions for certain other fringe benefits (see Miscellaneous Fringe Benefits, below).

Nondiscrimination rules

Under present law, exclusions for most of the statutory fringe benefits are conditioned upon compliance with rules prohibiting discrimination in favor of employees who are owners, officers, shareholders, and highly compensated employees. These nondiscrimination rules generally prohibit discrimination as to eligibility to participate and as to contributions or benefits.

A plan or program generally is required to meet the eligibility requirement by covering a classification of employees determined by the Internal Revenue Service not to result in prohibited discrimination. A self-insured medical reimbursement plan or group-term life insurance plan may also satisfy the requirement by covering a stated percentage of the employer's employees.

Generally employees covered by a collective bargaining agreement and who are not covered by a plan can be excluded from consideration in applying the nondiscrimination rules if the benefits provided by the plan or program are the subject of good faith bargaining between the employer and employee representatives. The eligibility rules for self-insured medical reimbursement plans also provide that employees need not be taken into account if they have not completed three years of service, have not attained age 25, or are part-time or seasonal employees.

The present-law nondiscrimination rules applicable to certain types of fringe benefit plans and programs also prohibit discrimination as to contributions or benefits. With respect to self-insured medical reimbursement plans, present law specifically requires that all benefits available to the 5 highest-paid officers, 10-percent shareholders, or the 25-percent highest-paid employees must also be available to all other plan participants.

Under present law, if a plan is found to discriminate in favor of employees who are officers, shareholders, or highly compensated, the otherwise applicable income exclusion generally is denied for all benefits provided under the plan, including those benefits provided for rank-and-file employees. (The nondiscrimination rules generally do not provide express guidance as to when an employee is considered highly compensated, or the extent of stock ownership required before an employee is considered a shareholder, because such factors depend on the facts and circumstances of individual cases.) However, under a discriminatory self-insured medical reimbursement plan or group-term life insurance plan, only those employees with respect to whom discrimination is prohibited are required to include amounts in gross income; other employees retain the benefit of the income exclusion.

Group-term life insurance

Under present law (sec. 79), the income exclusion for the cost of employer-provided group-term life insurance is subject to several limitations: (1) the exclusion is limited to the cost of the first

$50,000 of such insurance on the employee's life, computed pursuant to tables prescribed by the Treasury Department; (2) no exclusion is provided for any "key employee" (officers, five-percent owners, one-percent owners with compensation in excess of $150,000, and certain employee-owners) if the program discriminates in favor of key employees as to either eligibility to participate or the life insurance benefits actually provided under the plan; and (3) no exclusion is provided for self-employed individuals (sole proprietors or partners). The cost of group-term life insurance purchased by an employer for an employee for a taxable year is included in the employee's gross income to the extent that the cost is greater than the sum of the cost of $50,000 of life insurance plus any contribution made by an employee to the cost of the insurance. If a group-term life insurance plan maintained by an employer discriminates in favor of any key employee, the exclusion for the cost of the first $50,000 of this insurance is not available. In that event, the full cost of the group-term life insurance for any key employee is included in the gross income of the employee.

The Tax Reform Act of 1984 made three changes in the treatment of group-term life insurance. First, the $50,000 limitation on the amount of group-term life insurance that may be provided tax-free to employees also applies to retired as well as active employees (but not to disabled employees). Second, the nondiscrimination rules are applied to plans covering former employees, whether retired or disabled. Third, under the Act, if a plan fails to qualify for the exclusion because it is discriminatory, then key employees (whether active or former employees) must include in income the actual cost of their insurance benefit rather than the uniform table cost prescribed by the Treasury. The provisions of the Act are generally applicable to taxable years beginning after December 31, 1983.[2]

Under FICA, the entire amount of any payment on account of death made to, or on behalf of, an employee or dependents under a plan or system for employees generally or for a class or classes of employees is exempt from tax. Any amount paid by an employer for insurance or annuities or into a fund to provide for such a payment also is exempt from FICA (sec. 3121(a)(2)).

Death benefits

Present law generally excludes from a beneficiary's gross income proceeds of death benefits received under a life insurance contract (sec. 101(a)) and provides a limited exclusion for other benefits paid by or on behalf of an employer by reason of an employee's death (sec. 101(b)). As stated above, death benefits are entirely exempt from FICA if paid under a plan or system for employees generally or for a class or classes of employees.

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[2] The new provisions extending the $50,000 limitation and the nondiscrimination rules do not apply to any group-term life insurance plan in existence on January 1, 1984 (or to any comparable successor plan), but only with respect to those individuals who retire under the plan, who were employed during 1983 by the employer maintaining the plan, and who attained age 55 on or before January 1, 1984. Also, these new provisions generally do not apply to any employees who retired before January 1, 1984. However, the new rules will apply to any plan that is discriminatory after December 31, 1986, with respect to any individual retiring after that date.

The income tax exclusion for death benefits for employees not paid under an insurance contract is subject to several limitations: (1) only the first $5,000 of benefits attributable to any one employee is eligible for the exclusion; (2) amounts which are income in respect of a decedent (e.g., uncollected salary or unused vacation pay) are not eligible for the exclusion; (3) no exclusion is provided for amounts with respect to which the employee had a nonforfeitable right to receive the benefits, unless the source of payment is a qualified pension profit-sharing, or stock bonus plan or certain annuity plans; and (4) no exclusion is provided for amounts received under certain joint and survivor annuities if distribution to the participant had commenced prior to death. Except with respect to certain amounts payable from or under qualified plans, this exclusion generally is not available to self-employed individuals (sole proprietors or partners).

Accident and health benefits

Under present law, an employer's contributions to a plan providing accident or health benefits are excludable from the employee's income (sec. 106). No similar exclusion is provided for self-employed individuals (sole proprietors or partners).

Benefits actually paid to employees under accident and health plans generally are includible in the employee's gross income to the extent attributable to employer contributions (sec. 105(a)). Reimbursements for costs incurred for medical expenses (within the meaning of sec. 213) and disability payments which compensate for permanent injury and are computed without reference to the period of absence from work are excluded from gross income (secs. 105(b) and (c)). However, in the case of self-insured medical reimbursement plans (sec. 105(h)), no exclusion is provided for benefits paid to any employee who is among the 5 highest-paid officers, a 10-percent shareholder, or among the 25-percent highest-paid employees if the program discriminates in favor of this group as to either eligibility to participate or the medical benefits actually provided under the plan.

Under FICA, payment of medical or hospitalization expenses in connection with sickness or accident disability made to, or on behalf of, an employee or dependents under a plan or system for employees generally, or for a class or classes of employees, are exempt from social security tax. Any amount paid by an employer for insurance or annuities or into a fund to provide for such a payment also is exempt from FICA (sec. 3121(a)(2)).

Also, any payments to or on behalf of an employee on account of sickness or accident disability, or medical or hospitalization expenses in connection with such disability, are exempt from FICA after the expiration of six calendar months following the last calendar month in which the employee worked for the employer (sec. 3121(a)(4)). In addition, FICA exempts payments to employees on account of retirement for disability under a plan which makes provision for employees generally or a class or classes of employees (sec. 3121(a)(12)). Finally, any payment to an employee while the employee is entitled to disability insurance benefits under section 223(a) of the Social Security Act is exempt from FICA if the entitlement commenced prior to the calendar year in which the payment is made and if the employee did not perform any services for the employer during the period for which the payment is made (sec. 3121(a)(15)).

Parsonage allowances

Present law permits a minister of the gospel to exclude from gross income the rental value of a home provided as part of compensation, or a rental allowance paid as compensation to the extent used to rent or provide a home (sec. 107). The exclusion is subject to several restrictions: (1) the amount of the exclusion is limited to the rental value of the home or actual amounts paid to rent or provide a home; (2) the exclusion is available only if the home or rental allowance is paid as remuneration for services; and (3) the exclusion for rental allowance is available only if the employer designates such payment as a rental allowance in advance of payment.[3]

For social security tax purposes, ministers generally are treated as self-employed individuals subject to SECA (rather than as employees subject to FICA). SECA liability is computed without regard to the income tax exclusion for the rental value of parsonages (sec. 1402(a)(8)).

Benefits provided to members of the Armed Forces

Present law permits military personnel to exclude a variety of in-kind benefits and cash payments from gross income. Specific exclusions apply to certain disability pensions (sec. 104(a)(4)); qualifying combat pay (sec. 112); mustering-out payments (sec. 113); and subsistence, housing, and uniform allowances, as well as the value of quarters or subsistence provided in kind (Regs. sec. 1.61-1(b)). A similar exclusion is provided for FICA (sec. 3121(i)(2)).

Meals and lodging for the employer's convenience

Present law excludes from gross income the value of certain meals or lodging furnished to an employee (or to the employee's spouse or dependents) by or on behalf of the employer for the convenience of the employer (sec. 119).

The exclusion for meals is available only if the meals are furnished (1) on the employer's business premises and (2) for the convenience of the employer. The exclusion for lodging is available only if (1) the lodging is furnished on the employer's business premises; (2) the lodging is furnished for the convenience of the employer; and (3) the employee is required, as a condition of employment, to accept such lodging.

FICA exempts the value of any meals or lodging furnished by or on behalf of the employer if it is reasonable to believe that the employee will be able to exclude such items from income under section 119 (sec. 3121(a)(19)). For social security tax purposes, ministers generally are treated as self-employed individuals subject to SECA (rather than as employees subject to FICA). SECA liability is computed without regard to the income tax exclusion for meals and lodging furnished for the convenience of the employer (sec. 1402(a)(8)).

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[3] In 1983, the IRS ruled that ministers may not take deductions for mortgage interest and real estate taxes on their residences to the extent that such expenditures are allocable to tax-free housing allowances provided for ministers (Rev. Rul. 83-3, 1983-1 C.B. 72). The new deduction disallowance rule generally applied beginning July 1, 1983. Under a transitional rule, in the case of a minister who owned and occupied a home before January 3, 1983 (or had a contract to purchase a home before that date), the deduction disallowance rule generally will not apply until January 1, 1985. The 1984 Act extends this transitional rule date to January 1, 1986.

Legal services

Present law excludes from gross income employer contributions to a qualified prepaid legal services plan, as well as the value of any legal services received by, or amounts paid as reimbursement for legal services for, the employee or the employee's spouse or dependents (sec. 120). Also, the exclusion is available to self-employed individuals covered by qualified prepaid legal services plans.

This exclusion is subject to several limitations: (1) the program may provide only for personal (i.e., nonbusiness) legal services; (2) no exclusion is available if the program discriminates in favor of employees who are officers, shareholders, or highly compensated, as to either eligibility to participate or the benefits provided under the plan; and (3) no more than 25 percent of the employer contributions to the plan may be attributable to the group consisting of employees (and their spouses and dependents) who own more than five percent of the stock or of the capital or profits interest in the employer.

This exclusion is scheduled to terminate for taxable years ending after 1984.

FICA excludes any contribution, payment or service provided by an employer which may be excluded from gross income under section 120.

Van pooling

Present law excludes from an employee's gross income the value of certain employer-provided transportation ("van pooling") between an employee's residence and place of employment (sec. 124).

This exclusion is subject to several limitations: (1) the exclusion is available only for transportation furnished through use of a commuter van; (2) no exclusion is provided if the vanpooling arrangement discriminates in favor of employees who are officers, shareholders, or highly compensated; and (3) no exclusion is permitted for self-employed individuals (sole proprietors and partners).

This exclusion is scheduled to terminate for van pooling provided in taxable years beginning after 1985.

Dependent care assistance

Present law excludes from an employee's gross income amounts paid or incurred by an employer for dependent care assistance provided under a qualified dependent care assistance program (sec. 129). Also, the exclusion is available to self-employed individuals (sole proprietors or partners).

This exclusion is subject to several limitations: (1) the amount excluded may not exceed the employee's earned income (or, if the employee is married, the lower of the earned income of the employee or the employee's spouse); (2) the exclusion is only provided for expenses for household services or care of qualifying individuals (dependents under the age of 15 or physically or mentally incapacitated dependents or spouses) that are incurred to enable the taxpayer to be gainfully employed; (3) no exclusion is available for amounts paid for qualifying services rendered by the employee's dependent or child of the employee who is under the age of 19; (4) no exclusion is available if the dependent care assistance program discriminates in favor of employees who are officers, owners, or highly compensated individuals (or their dependents); and (5) no exclusion is available if more than 25 percent of the total benefits paid are for the group consisting of employees who own more than five percent of the stock or of the capital or profits interest in the employer (or their spouses or dependents).

FICA excludes any payment made or benefit furnished if it is reasonable to believe that employee will be able to exclude the payment or benefit from income under section 129 (sec. 3121(a)(18)).

B. Miscellaneous Fringe Benefits

Background

A moratorium first enacted in 1978 prohibited issuance of Treasury regulations relating to the income tax treatment of nonstatutory fringe benefits. The legislative moratorium expired on December 31, 1983. The Treasury Department has announced that Treasury and the IRS "will not issue any regulations or rulings altering the tax treatment of nonstatutory fringe benefits prior to January 1, 1985," and that "present administrative practice will not be changed during this period" (Ann. 84-5, 1984-4 I.R.B. 31).

General rule

The Tax Reform Act of 1984 provides a statutory exclusion from income and FICA and other employment taxes for (1) no-additional-cost services; (2) qualified employee discounts; (3) working condition fringes; (4) de minimis fringes; and (5) qualified tuition reductions. No fringe benefit (other than a de minimis fringe) is excluded under the Act if another section of the Code provides rules for the tax treatment of that general type of benefit.

Under the Act, any fringe benefit that does not qualify for a statutory exclusion is expressly includible in gross income, and subject to employment taxes, at the excess of its fair market value over any amount paid by the employee for the benefit.

The rules of the Act do not make any change in existing statutory or regulatory exclusions for benefits for military personnel.

Exclusion provisions

No-additional-cost service.—A service provided to an employee is excluded if—

(1) the employer incurs no substantial cost (including foregone revenue) in providing the service;

(2) the service is provided by the employer or another business with whom the employer has a written reciprocal agreement, and is of the same type ordinarily sold to the public in the line of business in which the employee works;

(3) the service is provided to a current or retired employee, or a spouse or dependent child of either, or a widow(er) or dependent children of a deceased employee; and

(4) for certain highly compensated employees, nondiscrimination requirements are met (see below).

Qualified employee discount.—A discount on merchandise provided to an employee is excluded to the extent it does not exceed the employer's gross profit percentage (in the relevant line of business). The exclusion does not apply to discounts on real property or to discounts on personal property of a kind commonly held for investment.

A discount on services provided to an employee is excluded to the extent it does not exceed 20 percent of the selling price of the services to nonemployee customers (with no gross profit percentage restriction).

The following conditions generally must be satisfied for the exclusion to apply:

(1) the property or service is provided by the employee and is of the same type ordinarily sold to the public in the line of business in which the employee works;

(2) the property or service is provided to a current or retired employee, a spouse or dependent child of either, or to a widow(er) or dependent children of a deceased employee; and

(3) for certain highly compensated employees, nondiscrimination requirements are met (see below).

Working condition fringe.—Property or services provided to an employee are excluded to the extent that they would be deductible as ordinary and necessary business expenses (under Code secs. 162 or 167) if the employee had paid for them.

The Act excludes, as a working condition fringe, the value of free or reduced-cost parking provided to employees on or near the employer's business premises.

De minimis fringe.—Property or services not otherwise tax-free are excluded if their fair market value is so small, taking into account the frequency with which similar fringe benefits (otherwise excludable as de minimis fringes) are provided and other relevant factors, as to make accounting for the benefits unreasonable or administratively impracticable. For example, benefits that generally are excluded as de minimis fringes include the typing of a personal letter by a company secretary, occasional personal use of the company copying machine, monthly transit passes provided at a discount not exceeding $15, occasional company cocktail parties or picnics for employees, occasional supper money or taxi fare for employees because of overtime work, and certain holiday gifts of property with a low fair market value.

Subsidized eating facilities operated by the employer also are excluded as a de minimis fringe if located on or near the employer's business premises, if revenue equals or exceeds direct operating costs, and if (for certain highly compensated employees) nondiscrimination requirements are met (see below).

Athletic facilities.—An exclusion is allowed for the value of on-premises athletic facilities provided and operated by an employer for use of its employees. Under Code section 274, the employer is not allowed a deduction for the costs of an athletic facility if the facility is not primarily for the benefit of employees (other than employees who are officers, shareholders or other owners, or highly compensated employees).

Qualified tuition reduction.—The Act provides that a reduction in tuition provided to an employee of an educational institution is excluded for income and employment tax purposes if (1) the tuition is for education below the graduate level provided by the employer or by another educational institution; (2) the education is provided to a current or retired employee, a spouse or dependent child of either, or to a widow(er) or dependent children of a deceased employee; and (3) certain nondiscrimination requirements are met (see above).

Nondiscrimination requirements.—The exclusions for no-additional-cost services, qualified employee discounts, subsidized eating facilities, and qualified tuition reductions are available to officers, owners, or highly compensated employees only if the property or service is provided on substantially the same terms to each member of a group of employees defined under a reasonable classification, set up by the employer, which does not discriminate in favor of employees who are officers, owners, or highly compensated employees.

Effective dates.—Under the Act, the provisions generally are effective beginning January 1, 1985. The provisions of the Act relating to qualified tuition reductions are effective for education furnished after June 30, 1985.

C. Benefits Provided Under a Cafeteria Plan

In general

Under a cafeteria plan, a participant is offered a choice between cash and one or more fringe benefits. The mere availability of cash or certain taxable benefits under a cafeteria plan does not cause an employee to be treated as having received the available cash or taxable benefits for income tax purposes if certain conditions are met (sec. 125). Thus, a participant in such a cafeteria plan is required to include in gross income only those taxable benefits actually received.

A highly compensated participant is treated as having received available cash and taxable benefits if the cafeteria plan discriminates in favor of highly compensated individuals as to eligibility or as to benefits or contributions. A highly compensated individual includes an officer, a five-percent shareholder, a highly compensated individual, or a spouse or dependent of any of the preceding individuals.

The cafeteria plan rules generally do not affect whether any particular benefit offered under the plan is a taxable or nontaxable benefit. Thus, a benefit that is excludable under the Code when offered separately is an excludable benefit under a cafeteria plan only if the rules providing for the exclusion of the benefit from gross income continue to be satisfied when the benefit is provided under the cafeteria plan.

IRS release, regulations

On February 10, 1984, the Internal Revenue Service issued a news release (IR-84-22), stating that so-called "flexible spending arrangements" offered as part of cafeteria plans do not provide employees with nontaxable benefits under the Code because employees are assured of receiving the amounts available under the arrangement without regard to whether covered expenses are incurred.

In May, 1984, the Internal Revenue Service issued proposed regulations with respect to the cafeteria plan rules and the statutory rules governing the exclusion of benefits from gross income. These proposed regulations provide that an otherwise nontaxable benefit will be nontaxable if offered in a cafeteria plan only if it continues to satisfy the provisions governing exclusion of the benefit from gross income. Accordingly, the proposed regulations provide that employer contributions with respect to an accident or health plan, a qualified group legal services plan, or a dependent care assistance program are not excluded from a participant's gross income under the Code to the extent that the participant is assured of receiving benefits under the plan without regard to whether the participant incurs covered expenses.

Provisions of the Tax Reform Act of 1984

The Tax Reform Act of 1984 provides that under a cafeteria plan, an employee generally can choose only among cash and fringe benefits that are excludable from gross income under a specific section of the Code (other than scholarships or fellowships, van pooling, and those benefits excludable under the miscellaneous fringe benefit provisions of the 1984 Act).

Also, the Act amends the cafeteria plan rules to provide that if, for a plan year, more than 25 percent of the total excludable benefits are provided to employees who are key employees with respect to the plan for such year (as determined under the rules of sec. 416(i)(1)), then the key employees will be taxed as though they received all available taxable benefits under the plan. Generally, in determining the portion of the total excludable benefits that is provided to key employees, coverage under a plan (e.g., an accident or health plan) and not actual expense reimbursements are to be counted.

Under the Act, certain reporting requirements are applied with respect to cafeteria plans. The Act provides both general and special transition relief through January 1, 1985, or, in certain cases, July 1, 1985, with respect to the proposed Treasury regulations on cafeteria plans, for cafeteria plans and "flexible spending arrangements" in existence on February 10, 1984. Finally, the Act provides that the Secretary of Health and Human Services, in cooperation with the Secretary of the Treasury, is to submit a report by April 1, 1985, to the House Committee on Ways and Means and the Senate Committee on Finance on the effect of cafeteria plans on the containment of health costs.

D. Welfare Benefit Plans

Deductions for contributions to funded benefit plans

The Tax Reform Act of 1984 modified the tax treatment of employers with respect to welfare benefits provided to employees. Under the Act, deductions for contributions to a welfare benefit fund are limited to qualified costs, generally defined as the sum of

(1) qualified direct costs and (2) additions, within limits, to a qualified asset account.

Limitations on qualified asset account.—The Act provides rules relating to the limitation on additions to a qualified asset account. Such an account consists of assets set aside for the payment of disability benefits, medical benefits, supplemental unemployment compensation or severance pay benefits, and life insurance or death benefits. To the extent the qualified asset account exceeds the account limit, additions to the account are not currently deductible.

In general, the account limit is the amount estimated to be necessary, under actuarial assumptions that are reasonable in the aggregate, to fund the liabilities of the plan for the amount of claims incurred but unpaid, for benefits described in the previous paragraph, and administrative costs of providing those benefits, as of the close of the taxable year. Claims are incurred only when an event entitling the employee to benefits, such as a medical expense, a separation, a disability, or a death, actually occurs. The allowable reserve includes amounts for claims estimated to have been incurred but which have not yet been reported, as well as those claims which have been reported but have not yet been paid.

Child care facilities and other capital expenditures.—Under the Act, in determining qualified direct costs with respect to a child care facility held by a fund, the adjusted basis of the facility is treated as deductible ratably over a period of 60 months. A child care facility is tangible property of a character subject to depreciation and located in the United States, and must be a child care center primarily for children of the employees of the employer. Qualified direct costs with respect to other capital expenditures are those that would be allowed under the usual Code rules which would be applied if the employer owned the asset.

Prefunding of life insurance, death benefits, or medical benefits for retirees.—The qualified asset account limit includes amounts reasonably necessary, within limits, to accumulate reserves under a welfare benefit plan for the medical benefit or life insurance (including death benefit) payable to a retired employee during retirement. These amounts may be accumulated no more rapidly than on a level basis over the working life of the employee with the employer, subject to certain additional limitations.

Safe harbor.—The Act provides that an actuarial certification by a qualified actuary (determined under Treasury regulations) justifying the taxpayer's reserve computations is not necessary if the amount in the qualified asset account does not exceed a prescribed safe harbor level equal to the sum of separate safe-harbor amounts computed with respect to each benefit for which a safe harbor is provided.

Certain collectively bargained plans.—The Act provides that before July 1, 1985, the Treasury Department is to publish final regulations establishing special reserve limit principles with respect to welfare benefit funds maintained pursuant to certain collective bargaining agreements.

Transitional rule.—Under the Act, in the case of a plan that was in existence on June 22, 1984, special rules are provided for the determination of the deduction limit for each of the first four years to which the provision applies.

10-or-more-employer plans.—For a plan year in which no employer (or employers related to an employer) is required to contribute more than 10 percent of the total contributions, the Act provides that the deduction limits do not apply.

Effective date.—These provisions generally apply to contributions paid or accrued after December 31, 1985. However, in the case of a plan maintained pursuant to a collective bargaining agreement in effect on July 1, 1985, or ratified before that date, the provisions do not apply until the termination of the contract, determined without regard to any contract extension agreed to after that date.[4]

Excise taxes on funded benefit plans

Under the Act, an excise tax is imposed on the employer equal to 100 percent of the disqualified benefits provided by a fund under a welfare benefit plan.

The Act defines a disqualified benefit as (1) any medical benefit or life insurance benefit provided with respect to a retired key employee (sec. 416(i)) other than from a separate account established for that employee under the new rules relating to deductions under funded welfare benefit plans (sec. 419A(d)); (2) any medical or life insurance benefit provided with respect to a retired employee unless the benefit is provided from a fund that meets the additional requirements for tax-exempt status provided by the Act (sec. 505(b)(1)); and (3) any portion of a welfare benefit fund reverting to the benefit of the employer.

These excise tax provisions generally apply to contributions paid or accrued after December 31, 1985. However, in the case of a plan maintained pursuant to a collective bargaining agreement in effect on July 1, 1985, or ratified before that date, the provisions do not apply until the termination of the contract, determined without regard to any contract extension agreed to after that date.

Tax treatment of exempt benefit organizations

Unrelated business income.—Under the Act, the special rules applicable to voluntary employees' beneficiary associations (VEBAs) and social clubs for purposes of the tax on unrelated business taxable income are extended to supplemental unemployment compensation benefit trusts (SUBs) and group legal service organizations (GLSOs). In addition, more specific limits are provided with respect to the amount that may be set aside for exempt purposes by such an organization without incurring unrelated business income tax; these limits generally are the same as those applicable for purposes of limitations on deductions for plan contributions.

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[4] In addition, the Act generally applies to any contribution of a facility to a welfare benefit fund after June 22, 1984. Under the Act, deductions with respect to such a contribution are to be determined under the usual Code rules applicable to recovery of the cost of assets (but taking account of the special rule for child care facilities described above). Further, these rules apply to other contributions, such as cash, made after that date which are to be used to acquire a facility, so that later acquisition of a facility with the use of such funds will limit the deduction for the original contribution. This rule does not apply for any facility acquired by the fund under a binding contract in effect on and at all times after that date, or any facility under construction by or for the fund before June 22, 1984.

The Act also provides for a tax on an employer who maintains a welfare benefit fund that is not exempt from income tax. Under the Act, in the case of any welfare benefit fund, such as a retired life reserve account, that is not exempt from income tax as a social club, VEBA, SUB, or GLSO, the employer who maintains the fund is to include in gross income for the taxable year an amount equal to the fund's deemed unrelated income. Deemed unrelated income is the amount of income which would have been subject to the unrelated business income tax if the fund were a tax-exempt organization.

Discrimination.—The Act establishes new nondiscrimination standards for a tax-exempt VEBA or GLSO. With respect to the nondiscrimination rules, certain employees who are not covered by a plan may be excluded from consideration in applying the nondiscrimination standards. These employees are employees who have not attained the age of 21, employees who have not completed 3 years of service with the employer, less than half-time employees, employees who are included in certain collective bargaining units, and certain nonresident aliens.

Effective date.—These provisions generally apply after December 31, 1985. However, in the case of a plan maintained pursuant to a collective bargaining agreement in effect on July 1, 1985, or ratified before that date, the provisions do not apply until the termination of the contract, determined without regard to any contract extension agreed to after that date.

The nondiscrimination provisions apply to taxable years beginning after December 31, 1984.

E. Qualified Pension, Profit-Sharing, and Stock Bonus Plans

If a pension, profit-sharing, or stock bonus plan qualifies under the tax law (sec. 401(a) or 403(a)), then (1) a trust under the plan is generally exempt from income tax, (2) employers are generally allowed deductions (within limits) for plan contributions for the year for which the contributions are made, even though participants are not taxed on plan benefits until the benefits are distributed, (3) benefits distributed as a lump sum distribution may be accorded special long-term capital gain treatment or 10-year income averaging treatment, or may be rolled over, tax-free, to an individual retirement account or annuity (IRA) or another qualified plan, and (4) certain partial distributions may be rolled over, tax-free, to an IRA.

Qualified plans are generally subject to minimum standards (including standards relating to employee participation, vesting, forms of benefits, and fiduciary conduct) and to limits on contributions or benefits. These plans are prohibited from discriminating in favor of employees who are officers, shareholders, or highly compensated. Pension plans are generally subject to a minimum funding standard. In addition, benefits under a defined benefit pension plan are generally guaranteed (within limits) by the Pension Benefit Guaranty Corporation.

Certain qualified plans may include a qualified cash-or-deferred arrangement (sec. 401(k)). Under a qualified cash or deferred arrangement, an employee may elect to receive compensation from the employer currently or to have the compensation deferred. Amounts deferred under a qualified cash or deferred arrangement are taken into account in computing social security and unemployment compensation benefits and taxes.

No minimum standards or special limits apply to an unfunded plan of deferred compensation. Generally, under ERISA, these plans may not be provided for rank-and-file employees.

Under a tax-sheltered annuity program, amounts paid by an educational institution or by an eligible tax-exempt organization to purchase an annuity contract for an employee are excluded from the employee's income, subject to certain limits (sec. 403(b)). Excludable contributions to custodial accounts investing in stock of a regulated investment company (e.g., a mutual fund) are also permitted. No nondiscrimination standard applies in the case of a tax-sheltered annuity program. Amounts distributed or made available under tax-sheltered annuities or custodial accounts generally are includible in gross income. However, certain distributions may be rolled over, tax-free, to another such annuity contract or to an IRA.

If an IRA qualifies as a simplified employee pension (SEP), the annual IRA deduction (generally, the lesser of $2,000 or 100 percent of compensation) is increased by the lesser of $30,000 or 15 percent of compensation. The increase in the deduction limit applies only to employer contributions (sec. 219). Except in the case of certain correcting distributions, all distributions from SEPs are includible in gross income unless rolled over to another IRA.

FICA generally excludes payments under or to a qualified pension, profit-sharing, or stock bonus plan, a SEP, a tax-sheltered annuity, an exempt governmental deferred compensation plan, or a plan to provide cost-of-living adjustments in benefits under these provisions. However, FICA applies to contributions under a qualified cash-or-deferred arrangement or to contributions under a tax-sheltered annuity made by reason of a salary reduction agreement (sec. 3121(a)(5)).

III. BACKGROUND DATA RELATING TO TAX TREATMENT OF CERTAIN FRINGE BENEFITS

A. Revenue Implications

Table 1 below shows the estimated increases in revenues that would result from terminating the present-law exclusions for those benefits described in Part II A and E of this pamphlet.

Each entry in the table has two lines. The first represents the estimated increase in income tax receipts that would result if the benefit were included in gross income. The second line shows the estimated increases in social security tax receipts that would result if the benefit were included in the FICA tax base.

In terms of revenue effect, qualified pension plans are the largest fringe benefit shown in this table, followed by health insurance. Each of the other fringe benefits shown in this table have less revenue impact.

Table 1. Effects of Including Certain Benefits in the Federal Income Tax Base and the FICA Tax Base

[In billions of dollars]

Item	1984	1985	1986	1987	1988	1989
1. Employer contributions for medical insurance:						
Income tax	17.6	20.2	23.0	26.2	29.9	34.1
FICA	6.7	7.7	8.8	10.1	11.9	13.7
2. Premiums on group term life insurance:						
Income tax	2.2	2.4	2.6	2.9	3.2	3.5
FICA	.5	.8	.9	.9	1.0	1.1
3. Contributions to prepaid legal services plans:						
Income tax	(1)	(1)				
FICA	(1)	(1)				
4. Employer provided child care:						
Income tax	(1)	.1	.1	.1	.2	.2
FICA	(1)	(1)	(1)	(1)	.1	.1
5. Employee meals and lodging (other than military):						
Income tax	.7	.8	.9	.9	1.0	1.1
FICA	.2	.2	.3	.3	.3	.3

Table 1. Effects of Including Certain Benefits in the Federal Income Tax Base and the FICA Tax Base—Continued

[In billions of dollars]

Item	1984	1985	1986	1987	1988	1989
6. Benefits and allowances to Armed Forces personnel:						
Income tax	1.9	2.0	2.2	2.3	2.4	2.6
FICA	(2)	(2)	(2)	(2)	(2)	(2)
7. Net exclusion for pension contributions and earnings						
Income tax	47.3	52.7	59.0	66.0	73.9	82.9
FICA	(2)	(2)	(2)	(2)	(2)	(2)

[1] Less than $50 million.
[2] Not available.

B. Growth in Certain Fringe Benefits

Tables 2 and 3 present data from the national income accounts on the growth between 1950 and 1981 of employer contributions to group health insurance and group life insurance, the two largest generally available statutory fringe benefits which are shown in Table 1, measured in terms of revenue effect.

Table 2 shows that during this period, these two benefits have grown considerably faster than wages and salaries. Group health insurance grew from 0.5 percent of wages in 1950 to 3.8 percent of wages in 1981, and group life insurance contributions increased from 0.2 percent of wages in 1950 to 0.4 percent of wages in 1981.

Group health insurance, has grown at a much faster rate than group life insurance. Group health insurance has continued to grow throughout the period, while group life has been approximately the same percentage of wages since 1965. Although many factors have influenced the growth of these two fringe benefits, it should be noted that the tax treatment of group term life insurance changed in 1964, when a limit was placed on the amount of employer contribution which could be excluded from gross income for income tax purposes.

Table 3 shows another way of examining the growth in employer contributions to health and life insurance during this period. These figures compare the increase in wages to the increase in the fringe benefit during this period.

Between 1950 and 1955, for example, health contributions increased 1.5 cents for every dollar of increase in aggregate wages. By the end of the period, health benefit contributions increased approximately 5.5 cents for each dollar of increase in wages. Thus, there was a significant acceleration in the growth of health benefits relative to wages over the 1950 to 1981 period, although this trend stabilized during the 1970s.

In contrast, increases in group term life insurance as percentage of wage increases declined over the 1950-1981 period. During the first five years, group term life insurance contributions increased 0.5 cents for every dollar of wage increase. This figure reached a peak during the last part of the 1950s. Since that time, however, the increase in life insurance as a percentage of wage increases declined significantly, so that by 1981 these contributions increased by only 0.3 cents for every dollar of wage increases.

Table 2. Employer Contributions to Group Health and Life Insurance as Percentage of Wages and Salaries, United States, 1950–1981

[In percent]

	Group Health	Group Life
1950	0.5	0.2
1955	0.8	0.3
1960	1.3	0.4
1965	1.6	0.5
1970	2.2	0.5
1975	3.0	0.5
1980	3.7	0.5
1981	3.8	0.4

Source: Computed from U.S. Department of Commerce data.

Table 3. Increase in Total Employer Insurance Contributions as Percentage of Total Increase in Wages, United States, 1950–1981

[In percent]

	Group Health	Group Life
1950–55	1.5	0.5
1955–60	2.8	0.9
1960–65	2.7	0.6
1965–70	3.3	0.7
1970–75	4.7	0.6
1975–80	4.5	0.3
1980–81	5.5	0.3

Source: Computed from U.S. Department of Commerce data.

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Chairman **Pickle**. This is a joint hearing today of the Subcommittee on Social Security and Subcommittee on Select Revenue Measures on the Committee of Ways and Means. We sit today on a joint committee basis. As chairman of the Social Security Subcommittee, I welcome you all here this morning as these two subcommittees meet on the question of the distribution and economics of the employer-provided fringe benefits.

I am glad these hearings are at long last being held. I have recommended on a number of occasions during the past year that hearings be held to examine the whole subject of employee benefits to give Congress a better understanding of this enormous subject and to allow employers and employees to present their views.

The only purpose of these hearings is to gather information, to ask questions, and to explore as fully as possible in the time we have all of the various forms of employee benefits. But I want to stress to you that these hearings are not intended to be a forum for competing philosophies. Such a hearing would not serve any purpose.

We are not considering any specific legislation. We are not proposing any course of action. We simply want to understand this subject better. I want to make it clear that I do not think that Congress has any intentions of taking away fringe benefits. This is not the purpose of this hearing.

On the contrary, Congress acted this summer to eliminate some of the uncertainty in the fringe benefit area in the Deficit Reduction Act, by legislation that came from the Subcommittee on Select Revenue Measures itself. So there is no need for anyone to get frightened about this or to launch a campaign to lobby Members of Congress to protect certain fringe benefits.

All we want to do is to examine the issues calmly, responsibly and thoroughly. The issues here are too important for our national economy, for our employees, our businesses and for the Federal Government to let us continue heading blindly on. Congress must decide in the years ahead whether there is a need to take any further action in this area and, if so, what action should be taken.

I hope these hearings will allow us to gather the hard facts we in Congress and you in the public can use to make responsible decisions. In conclusion, let me say that I am glad you could all be here to assist us in this endeavor. I look forward to hearing and studying your testimony.

As I said, I am joined here this morning by my colleague, Mr. Pete Stark, chairman of the Subcommittee on Select Revenue Measures, who has taken a very positive lead in examining this issue previously and has brought us some very important legislation on the subject. I am pleased to yield to him on this at this time to make any statement at the beginning of this hearing that he would care to make. Mr. Stark?

Chairman **Stark**. Thank you, Mr. Chairman. It is a pleasure to be here with you and share this podium with your subcommittee. The work which our subcommittee did this summer was to establish, I guess, a guidance for what will be allowed as fringe benefits in the Tax Code. Actually, anybody can pay any kind of fringe benefit to any employee that they choose. The only issue is who will pay taxes if anyone, on the value of the particular fringe.

Chairman Pickle is to be commended for often a lonely vigil to protect the base on which the FICA and FUTA taxes are levied. And Jake takes a marvelously statesman-like long-range view of protecting retirement and Medicare system that is so important to so many Americans. I share his concern that this is not a hearing that is intended to open up debate on what additional fringes should be made tax free or indeed, on the other hand, we certainly have no intention of taking any existing fringes and subjecting them to income tax.

There is concern that I share about the growing creativity and growing number of fringe benefits. And at some point, we are going to have to face the question if it can be established, that the wage base will be decreasing greatly over the next decade. It may impinge on the social security financing and we may have to do something. But I am not sure that any member of either subcommittee has any preconceived notions.

I welcome the chance to discuss this in terms particularly of how much revenue we are losing and might indeed lose in the future if a variety of alternatives are taken. And I appreciate and applaud Chairman Pickle for his interest in taking the lead in bringing these hearings about, because they have been long overdue.

Chairman PICKLE. Thank you, Mr. Stark. Mr. Duncan, would you care to make a statement?

Mr. DUNCAN. I have no prepared statement, Mr. Chairman. I appreciate the fact that you have assured those present and others who have an interest in the subject that we are not going to do anything that would jeopardize the fringe benefit legislation passed last year.

We have been on this subject for several years. I hope these hearings allow us to finally establish a permanent set of fringe benefit rules. I thank you for calling these hearings.

Chairman PICKLE. Mr. Gradison.

Mr. GRADISON. Thank you, Mr. Chairman. I, too, would like to congratulate the chairmen of the two subcommittees for these hearings, which are very timely. It appears to me that we have had an extraordinary growth in fringe benefits; that fringe benefits have been growing faster than cash compensation and that tax-free fringe benefits have been growing faster than other kinds of fringe benefits.

This, no doubt, is what Congress intended. But there are some problems and I hope that these hearings will help us gain additional insight into whether these problems are serious or not. Certainly the narrower the tax base, the higher the tax rates. Those of us who are concerned about bringing tax rates, especially marginal rates, down lower than they are today, necessarily have to show some concern about the extent to which the tax base is being narrowed.

In addition, I think we have to recognize that these fringe benefits are not available to everybody on an entirely fair basis. Employees of small businesses generally don't fare as well as employees of larger businesses. Lower paid employees don't usually come out as well as higher paid employees. Sole proprietors and farmers operating as sole proprietorships are particularly disadvantaged as against employees of corporations.

One of the disquieting things to me, Mr. Chairman, is that the ink was barely dry on the Deficit Reduction Act, which attempted to put to rest the uncertainty about these fringe benefits and their taxation, when pressures began to build up for changes—liberalizations in some of the actions taken by the Congress and this committee last year.

I am especially glad that the announcement for this hearing indicated that we were interested in comments on the idea of caps. I personally think that these are worth thinking about and exploring, not necessarily with the idea that anything is going to happen tomorrow, but with the recognition that, as we look into the future, something along this line may be appropriate if we are going to continue to move in a meaningful way to lower tax rates.

Thank you, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Gradison.

Let me make it plain that this is a joint subcommittee hearing and that I am not calling this hearing by myself. The leadership on this program in many respects has come from the Subcommittee on Select Revenue Measures. I appreciate the work they did last year. This is a joint hearing. It is to be held because not only are both our subcommittees affected by this, but the entire Congress and business community are likewise affected.

So that is why it is a joint hearing. I also say to you, Mr. Gradison, I am pleased—yesterday I noticed on the TV that you appeared on a show on this general subject. I thought your comments were appropriate and were helpful. I think we probably will see other programs like this as we move forward. This is a very important element in our Nation's economy.

Mr. GRADISON. Thank you for mentioning that, Mr. Chairman. Unfortunately, I was dealt the unpopular side. I hope it didn't show in my district.

Chairman PICKLE. Well, you were responsible, Mr. Gradison. I appreciate it.

Our first witness this morning will be Mr. Ronald Pearlman, who is the Acting Assistant Secretary for Tax Policy. Mr. Pearlman, we are glad you could be with us this morning and share your views with us. If you will proceed, we will be glad to have your testimony.

STATEMENT OF RONALD A. PEARLMAN, ACTING ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. PEARLMAN. Thank you, Mr. Chairman, Mr. Stark, members of the subcommittee. I appreciate the opportunity of being here this morning so that we can discuss the Treasury Department's views on the appropriate taxation of employer provided fringe benefits.

As several members of the subcommittees have already mentioned, the Deficit Reduction Act of 1984 made several significant changes in the rule governing fringe benefits. We think that in general, the actions taken by the Congress this summer were appropriate steps in rationalizing the tax treatment of employer provided benefits.

Needed clarification was provided to individual taxpayers and employees alike and progress was made in limiting the expansion of fringe benefits. This morning I would like to outline the areas of continuing concern to the Treasury Department with respect to the tax treatment of employee fringe benefits.

We are concerned, as Mr. Gradison apparently is concerned, that the expansion in fringe benefits excluded from the Federal income and Social Security tax bases has caused tax rates to be higher than they would otherwise be. Our efforts in recent years to contain increases in marginal rates and our continuing efforts to try to contain those increases in the future, as well as increases in the Social Security tax rates, could be undermined quickly and significantly by any major narrowing of the range of compensation subject to tax.

We also are concerned that the tax benefits derived from the existing statutory fringe benefits are not fairly distributed among taxpayers. Finally, we are concerned that, in some instances, the exclusion of benefits from gross income fails to promote the policies underlying such favorable treatment.

I would like to begin my comments by focusing first on the impact on the income and social security tax bases of statutory nontaxable benefits. One of the announced purposes of these hearings was to gather information concerning the prevalence and consequent revenue implications of tax-favored fringe benefits.

Studies in this area indicate that the volume of tax-favored benefits has grown dramatically over the past several years and significant future growth will occur even if current restrictions on the availability of such fringe benefits are maintained. If these restrictions are relaxed in any significant way the inevitable result would be further, possibly serious erosion in both the Social Security and income tax bases.

In recent years the list of statutory fringe benefits has grown to include employer-provided programs aimed at promoting expenditure of compensation in specified ways. These more recent statutory fringe benefits include employee stock ownership plans, group legal service programs, van pooling, educational assistance programs and dependent care assistance programs.

We have estimated the nontaxable employer contributions for qualified pension and profit-sharing plans, group health insurance and group life insurance from the period from 1955 through the present and have projected such contributions through 1989. We have also calculated the portion of total wages these contributions have constituted and the revenue effect of excluding these contributions from the Federal income tax and Social Security tax bases.

These estimates are summarized in table 1 attached to the testimony. And I think it is interesting to look at table 1. You will see that it covers the period from 1955 through 1989. A couple of things will jump out at you if you look at the table. First, if you look at the very bottom line of the table the percentage of wages that were attributable to these three categories of statutory fringe benefits—and let me point out here that this does not include a number of the newer fringe benefits that have been enacted in more recent years—was 3.2 percent of total wages in 1955.

By 1975, a 20-year period, that number had grown to 8.5 percent of taxable wages, with most of the growth occuring in the pension and profit-sharing area. From 1975, forward, if you look again, for example, from the period 1975 to 1985, which includes a projected period, but a fairly short period of projection—most of it is actual data—you will see that the growth again is dramatic.

Indeed, it is about the same number of absolute percentage points, five, as has occurred during the first 20 years—slightly less than five. But the contrast I think you will see is that the growth is not in the pension and profit-sharing area. There has been some growth there. I suspect in part because of Congress' actions in connection with ERISA, that has been stemmed a bit, but the growth in group health insurance has been dramatic.

You can see the growth has more than doubled from 1975 through the projected period of 1989 and has grown very dramatically, although it has not quite doubled from 1970 into the early 1980's. So I think this table would say to us that there is a—there has been a dramatic growth in the amount of wages that has been excluded from the income tax base because of the growth in the nonstatutory fringe area and that indeed if you look at the period from 1983 to 1989, even though the percentage growth is not as dramatic, of course, the dollars involved are very substantial, that the growth is projected to continue.

It is the expansion in the scope and volume of tax-favored fringe benefits that represents a significant threat to the Federal income tax and Social Security tax bases. If pressures to increase Social Security and marginal income tax rates are to be resisted, hard choices must be faced as to which fringe benefits can be granted tax-favored treatment and as to whether the tax advantages currently available to fringe benefits can be modified without impairing the social policy objectives underlying their favorable tax treatment. This is a challenge, I think, that is both on us and the committee.

Now I would like to turn to a discussion of one of the more contemporary areas of statutory fringe benefits; namely, cafeteria plans and so-called flexible spending arrangements which were the subject of recent regulations by the Treasury Department and were the subject of some legislation action in the Deficit Reduction Act.

Recent growth in tax-favored benefits provided under employer-sponsored plans has been stimulated by the statutory authorization of cafeteria plans. This is so because they permit individual employees to choose which fringe benefits they will receive, in effect allowing employees to design fringe benefit packages tailored to their individual needs.

We recognize that where an employer has historically provided his employees with a very rich tax-favored benefit fringe package, a cafeteria plan may result in a net decrease in the tax benefit increase received by such employees. However, in the aggregate, cafeteria plans significantly narrow the Federal income and Social Security tax bases.

For fiscal years 1984 through 1989, we estimate that assuming the continued exclusion of group legal services through December 31, 1984, cafeteria plans will reduce individual income tax receipts by $5.5 billion and Social Security receipts by $3.2 billion, for a total reduction of $8.7 billion.

I think some information on the growth of those revenue receipts impact should be of interest on the committee. Our estimate revenue reduction for 1984 will be approximately $67 million. For 1985, we expect that revenue impact to more than double to a deficit of about $248 million, growing to $1 billion in 1987 and to a staggering $4.4 billion in 1989.

These projections indicate that cafeteria plans provide a powerful incentive for tax-favored forms of compensation. Even more substantial losses in revenue would result, however, if the cafeteria plan rules authorized the exclusion of benefits provided through so-called flexible-spending arrangements. Generally, a flexible-spending arrangement permits an employee to designate some portion of his or her otherwise taxable salary as available for the tax-free reimbursement of specified expenses, such as medical care, legal services, or dependent-care assistance. Under an FSA, the employee is assured of receiving, in the form of cash or some other benefit, any portion of the designated amount not utilized for the specified expense.

We have concluded, as I am sure you are aware and as proposed Treasury regulations on cafeteria plans reflect, that the statutory provisions granting tax-favored treatment to specified benefits and the cafeteria plan rules themselves do not authorize FSA's. Therefore, a benefit does not fall under any of the applicable statutory exclusions if the benefit is provided through an FSA.

Our revenue estimates indicate that FSA's would have a dramatic effect on the Federal tax base. For the 1984 through 1989 fiscal years, assuming that the exclusion for group legal services is not extended beyond December 31, 1984, we estimate that the $8.7 billion projected revenue loss attributable to cafeteria plans would double to approximately $17 billion if favorable treatment were granted to FSA's.

Turning again, this time to welfare-benefit funds, including VEBA's, let me make a few comments. In general, the costs of employee compensation, including employer-provided welfare benefits, are deductible by the employer at the time when the compensation is actually provided to the employees. In addition, if an employer sets aside amounts for future employee compensation, income earned on the amounts set aside is included in the emloyer's gross income for income tax purposes.

Exceptions to these general rules have permitted employers, in certain circumstances, to deduct currently contributions to prefund deferred welfare benefits. The critical advantage to an employer in setting aside funds in VEBA's and other effectively tax-exempt entities is that the income on such funds accumulates on a tax-exempt basis.

The historical development of the VEBA rules indicates that the effectively unlimited tax-exemption for VEBA's did not come about in a considered and deliberate fashion by the Congress. Indeed, before the Deficit Reduction Act, Congress seems not to have appreciated the potentially substantial tax benefits that an employer could derive through a VEBA. Instead, Congress generally viewed VEBA's simply as vehicles through which employees could join together to provide certain welfare benefits for themselves without adverse tax consequences.

In recent years, however, the growth in the number of VEBA's has substantially accelerated. According to the IRS, 7,091 active VEBA's had received favorable tax IRS determination letters from the commencement of VEBA's in the late 1920's through November 30, 1980. By the end of 1983, however, more than 9,400 VEBA's had received favorable determination letters.

Thus, over 17 percent of the VEBA's in existence as of the end of 1983 have come into existence during the last 3 of the 55 years for which VEBA's have been tax exempt. One of the reasons for this recent increase was, in our opinion, enactment of the additional limit, reduction in the section 415 limit on contributions and benefits and the top heavy rules on qualified pension and profit-sharing plans in TEFRA. VEBA's are subject to neither of these restrictions.

The Deficit Reduction Act does contain rules that limit the extent to which an employer may use a VEBA or similar entity to provide deferred benefits to employees. Let me say we think the efforts made by the Congress in the Deficit Reduction Act were very constructive in trying to restrict the scope of VEBA's. In spite of these very important limits, however, significant tax benefits remain for employers using VEBA's or similar entities.

I would like to turn now and comment for a moment on the horizontal inequity of statutory fringe benefits. This really is a comment that can apply to all statutory fringe benefits.

The exclusions for fringe benefits from gross income generally are conditioned upon the delivery of the benefits through an employer-sponsored plan. The limitation of tax-favored benefits to employees covered by an employer plan may be seen to discriminate against individuals not so covered. That is, people, for example, who are self-employed.

This latter group of noncovered individuals must pay for benefits, such as health care, with after-tax dollars, whereas covered employees are able to purchase the same benefits with pretax dollars. We have prepared some data showing the percentage of civilian employees in different income classes who are covered by pension or profit-sharing plans as well as the percentage who are covered by employer-provided group health insurance. This data is summarized in table II, attached at the end of this testimony. As is reflected in table II, the percentage of employees covered in the very lowest income categories is substantialy smaller than for both the middle- and upper-income groups.

Now a couple conclusions can be reached from that. One certainly is the question about the fairness of the existing tax treatment of fringe benefits and whether they are—whether the taxation produces an unfair distribution of such benefits among income groups. Current data showing significantly lower employer plan coverage for lowest paid employee groups itself, however, is of concern to us.

We would suggest that a comprehensive judgment about fairness should await additional data which we, and I think it is accurate to say, HHS, is undertaking to develop. Let me make one other comment regarding this table and the problem of horizontal inequity. And that is, we think that there may well be a correlation between people who are in the lower income groups and those people who are not typically covered by employer-provided benefits.

But I would not want to suggest to you that there is an absolute correlation and therefore again, I would recommend that you not take these data as an absolute conclusion that current rules provide unfairness in our system among income groups. But we did want to make that data available.

Chairman PICKLE. I would like for you to refer to table 2 in a little more detail so we can understand it.

Mr. PEARLMAN. OK.

Chairman PICKLE. I have it before me now.

Mr. PEARLMAN. All right.

Chairman PICKLE. Would you walk us through that table?

Mr. PEARLMAN. Certainly. I will try to do that for you.

What this table is designed to show is, if you look at employees and the amount of wages they get, just using wage categories, that is, under $5,000, $5,000 to $10,000 and so forth, and I should emphasize we are talking about wages here, not taxable income or the like, then the first column will show the number in millions. Excuse me. In thousands. But it turns out to be millions of employees in each category.

So for example, we have 17.7 million workers who earn $5,000 or less.

Chairman PICKLE. All right.

Mr. PEARLMAN. The next two categories, excuse me, the next two columns identify the number and percent of workers covered by pension plans. That is, employer-sponsored pension plans. For example, again looking at the less than $5,000 category, you will find 1.5 million employees or workers covered by employer-sponsored pension plans representing 8.8 percent of the entire work force in that wage category.

Now, the percentage of the entire work force in a wage category would include, of course, people not covered by employer-provided plans. The same approach is taken with respect to health plans.

Chairman PICKLE. Are you saying that the total wage of salary workers in the first category, 5,000, there would be some 17 million of them, and that in the percentage of workers with pension programs there would be 8 million? Am I interpreting this correctly?

Mr. PEARLMAN. I have missed your 8 million. Oh, that is 8 percent.

Chairman PICKLE. That is percentage. Yes.

Mr. PEARLMAN. If you look at the prior column, 1.5 million.

Chairman PICKLE. Yes.

Mr. PEARLMAN. Then that is the number.

Chairman PICKLE. I have got you. Now, you are comparing the 17,766,000 to the 1,568,000?

Mr. PEARLMAN. Yes; but let me emphasize again, Mr. Chairman, that the total wage and salary worker column includes people not covered by the employer-provided plans, OK?

Chairman PICKLE. Yes.

Mr. PEARLMAN. So what we are trying to show you by this table is how many of the total work force are covered by employer-provided plans, and how many, because they are self-employed, for example, are not. And what this table suggests clearly is that people in the lower wage categories are less likely to be covered both by pension plans and health plans. And the caution—that is of concern to us. That raises to us questions of fairness. But what I want to caution is, I wouldn't go overboard in attaching final judgment to this data. We are still working on this data and we hope to be able to provide more definitive data in the coming months.

Let me also just emphasize to you the footnote to that table, which is a very important footnote. And that is that when you are looking, particularly with health coverage, this has to do with health coverage, at people covered in two-earner families, where both spouses are working, obviously, typically there will be an incentive for one to choose not to be covered because the other spouse is covered. And we have to make sure in looking at health plan coverage that we take that into consideration in making the judgment as to whether the distribution data accurately presents data we can use for evaluating fairness.

Can I go on, Mr. Chairman?

Chairman PICKLE. Yes.

Mr. PEARLMAN. Another area where we certainly want to make sure that in making judgments about current statutory fringe benefits and about future statutory fringe benefits is the area of nondiscrimination. We think that the Congress has very properly made, as a basic justification for providing a tax benefit in the form of an exclusion from gross income, the objective of promoting the delivery of the tax-favored fringe benefit to a broad cross section of employees on a nondiscriminatory basis.

It is thus important that effective coverage and nondiscrimination rules apply with respect to each employer-provided benefit eligible for an exclusion from gross income.

Coverage and nondiscrimination rules apply to most tax-favored benefits, such as group-term life insurance, self-insured medical reimbursement plans, group legal service plans, and dependent care assistance programs. However, medical plans provided by an employer under a policy with an insurance company are not subject to nondiscrimination rules. Thus, discrimination in favor of the key and highly compensated employees still is possible in the case of insured health plans.

We also are concerned that cafeteria plans undermine the effectiveness of the statutory coverage and nondiscrimination rules that presently apply with respect to each of the statutory exclusions. These coverage and nondiscrimination rules generally are based on the availability of the particular benefit provided under the plan. In the absence of a cafeteria plan, an availability-type test ordinarily will assure that the benefit is provided to a broad cross section of employees on a nondiscriminatory basis. Availability-based tests, however, are not effective where employees are free to trade tax-favored benefits for cash or other benefits. Also, the existing coverage and nondiscrimination rules applicable to cafeteria plans generally are not adequate to assure that the basic coverage and nondiscrimination objectives are being protected.

Now, the last part of my testimony, Mr. Chairman, deals with health policy considerations. And the basic message we are sending there is that we think that there is a serious question as to whether tax incentives provided in employer-provided welfare benefit and health plans really are in fact achieving other important policy objectives. Most specifically, our objective in trying to contain health costs. My written testimony can stand for what it states. I am, however, willing to defer, because of Mr. Helms' presence from HHS, to him to comment on health policy considerations which are clearly more in his expertise than they are mine.

Chairman STARK. Would the gentleman yield for just a moment because I wanted to ask, Mr. Helms touches on this in his testimony, do you have any feeling, you mentioned what we had done in nondiscrimination. One of the major areas which we have not placed nondiscrimination rules is in health insurance. Mr. Helms' testimony touches on the fact that the same distortion in the distribution lies in that.

Do you think it is conceivable that we should put nondiscrimination rules and have them apply to health insurance as well?

Mr. PEARLMAN. I think, Mr. Stark, our belief is what, I think, in general Congress' belief has been. And that is nondiscrimination rules generally should be applicable to all statutorily provided fringe benefits.

Again, Mr. Chairman, because I think Mr. Helms can better comment on the health policy issues than I can, I think I am going to stop at this point. I appreciate the opportunity of being here this morning and giving you our comments. We have a mandate, as you know, from the Congress to provide some additional data to you in the area of statutory fringe benefits. And we will be doing that. And as is usual, we are happy to not only try to answer your questions this morning but provide you any additional assistance we might be able to provide. Thank you.

[The prepared statement follows:]

STATEMENT OF RONALD A. PEARLMAN, ACTING ASSISTANT SECRETARY (TAX POLICY), DEPARTMENT OF THE TREASURY

Mr. Chairman and Members of the Subcommittees: I am pleased to appear before you today to present the Treasury Department's views on the appropriate tax treatment of employer-provided fringe benefits.

In the recently enacted Deficit Reduction Act of 1984, Congress made several significant changes in the rules governing fringe benefits. Among the more important of these were (i) the extension to retired employees of the limits applicable to tax-favored group-term life insurance; (ii) the application of deduction and other limits to voluntary employees' beneficiary associations (VEBAs) and other welfare benefit funds; (iii) the codification of an exclusion for formerly nonstatutory fringe benefits, such as employee discounts and free parking; and (iv) the exclusion from cafeteria plans of taxable benefits other than cash, group-term life insurance in excess of $50,000, certain taxable life insurance for dependents of the employee, and vacation days. The Deficit Reduction Act also adopted reporting requirements, key employee limits, and special transition rules for cafeteria plans.

The Deficit Reduction Act was an appropriate step in rationalizing the Federal tax treatment of employer-provided fringe benefits. Needed clarification was provided to individual taxpayers and employers alike, and progress was made in limiting the expansion of fringe benefits.

My testimony today will outline areas of continuing concern to the Treasury Department with regard to the tax treatment of employee fringe benefits. I will focus on the so-called statutory fringe benefits, those benefits exempted from tax under specific provisions of the tax law, and will discuss in particular the growth in fringe benefits provided under employer-sponsored welfare benefit plans.

We are concerned that the expansion in fringe benefits excluded from the Federal income and social security tax bases has caused tax rates to be higher than they would otherwise be. Our efforts in recent years to contain increases in marginal rates of income taxation and in the social security tax rates could be undermined quickly by any significant narrowing of the range of compensation subject to tax.

We also are concerned that the tax benefits derived from the existing statutory fringe benefits are not fairly distributed among taxpayers. Current provisions direct a disproportionate share of such preferences to individuals able to participate in employer-sponsored benefit plans.

Finally, we are concerned that in some instances the exclusion of benefits from gross income fails to promote the policies underlying such favorable treatment.

IMPACT ON THE INCOME AND SOCIAL SECURITY TAX BASES

Statutory Nontaxable Benefits.—One of the announced purposes of these hearings was to gather information concerning the prevalance and consequent revenue implications of tax-favored fringe benefits. Our studies in this area indicate that the volume of tax-favored fringe benefits has grown dramatically over the past several years and that significant future growth will occur even if current restrictions on the availability of tax-favored fringe benefits are maintained. If these restrictions are relaxed in any significant way, the inevitable result would be further and possibly serious erosion in the social security and income tax bases.

Generally, an employee is required to include in gross income, for both Federal income and social security tax purposes, all amounts received as compensation, whether in the form of cash or any other benefit, including welfare benefits. Subject to statutory limits, however, benefits provided under an employer-sponsored plan that satisfies the applicable Code provisions are excluded from the income and social security tax bases.

Generally, an employer-provided benefit qualifies for an exclusion only if the plan satisfies certain eligibility, coverage, and nondiscrimination rules. (A notable exception is health benefits provided by an employer under a policy of insurance with an insurance company.) The purpose of these rules is to assure that the tax-favored benefit is provided to a broad cross-section of the employer's employees on a nondiscriminatory basis.

Prior to the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), the major statutory fringe benefits were qualified pension and profit-sharing plans, group-term life insurance, and medical benefits. The favorable tax treatment was intended to encourage employers to provide benefits that would protect employees and their families from hardship on account of contingencies such as separation from service, death, and sickness or disability. Beginning with ERISA, however, the list of statutory fringe benefits has grown to include employer-provided programs aimed not at encouraging the extension of protection against hardship resulting from specified contingencies, but instead merely at promoting the expenditure of compensation in specified ways. These more recent statutory tax-favored benefits include employee stock ownership plans, group legal services programs, van pooling, educational assistance programs, and dependent care assistance programs.

The expansion of the statutory nontaxable benefits has the effect of reducing the cost of a broad range of goods or services that are purchased by a wide spectrum of the population. Predictably, this expansion has put pressure on employers to provide increasing portions of compensation in tax-favored forms so as to maximize the "tax effectiveness" of employee compensation packages.

We have estimated the nontaxable employer contributions for qualified pension and profit-sharing plans, group health insurance, and group life insurance for the period from 1955 through the present, and have projected such contributions through 1989. Also, we have calculated the portion of total wages that these contributions have constituted, and the revenue effect of excluding these contributions from the Federal income and social security tax bases. These estimates are summarized in Table I, attached at the end of this testimony.

Table I illustrates that, as a percentage of total wages, the total nontaxable employer contributions for qualified pension and profit-sharing plans, group health insurance, and group life insurance were 3.2 percent in 1955, 5.2 percent in 1965, 8.5 percent in 1975, and 11.1 percent in 1983. We project that this percentage will be 11.5 percent in 1985 and will increase further to 13.4 percent in 1989. In 1983, excluding these employer contributions from the Federal income and social security tax bases reduced Federal income tax revenues by about $53 billion and social security tax revenues by about $11 billion; for 1985 the corresponding revenue reductions are projected to be $64 billion and $14 billion.

The expansion in the scope and volume of tax-favored fringe benefits represents a significant threat to the Federal income and social security tax bases. If pressures to increase social security and marginal income tax rates are to be resisted, hard choices must be faced as to which fringe benefits can be granted tax-favored treatment and as to whether the tax advantages currently available to fringe benefits can be modified without impairing the social policy objectives underlying their favorable tax treatment.

Cafeteria Plans and Flexible Spending Arrangements.—Recent growth in tax-favored benefits provided under employer-sponsored plans has been stimulated by the statutory authorization of cafeteria plans. Cafeteria plans permit individual employees to choose which fringe benefits they will receive, in effect allowing employees to design fringe benefit packages tailored to their individual needs.

The flexibility inherent in cafeteria plans substantially eliminates "employee jealousy" as a restraint on the amount of compensation provided in tax-favored forms. In the absence of a cafeteria plan, employees would choose compensation in the form of nontaxable fring benefits only if the benefits were more desirable than the after-tax value of the additional salary that would otherwise have been paid. Because the desirability of particular benefits differs from employee to employee, fringe benefit compensation generally is sought by some employees and opposed by others. Employee disagreement over the desirability of particular nontaxable benefits historically has served as an important restraint on the amount of compensation provided in any particular form. Cafeteria plans virtually eliminate this restraining factor by permitting individual employees to select the fringe benefits which meet their particular needs.

Also, where an employer is unwilling to provide additional benefits on a tax-favored basis, cafeteria plans enable employees to use pre-tax dollars, rather than after-tax dollars, to purchase such additional benefits. For example, in the absence of a cafeteria plan, an employee would have to make the required employee contribution to a contributory medical plan with after-tax dollars. But if the employer makes the contributory medical plan available through a cafeteria plan, the employee would be able to make the required contribution with pre-tax dollars.

We recognize that, where an employer historically has provided its employees with a very rich, tax-favored fringe benefit package, a cafeteria plan may result in a net decrease in the tax-favored benefits received by such employees. However in the aggregate, cafeteria plans significantly narrow the Federal income and social security tax bases. For fiscal years 1984 through 1989, we estimate that, assuming the exclusion for group legal services is not extended beyond December 31, 1984, cafeteria plans will reduce individual income tax receipts by $5.5 billion and social security receipts by $3.2 billion, for a total reduction of $8.7 billion.

These projections indicate that cafeteria plans provide a powerful incentive for tax-favored forms of compensation. Even more substantial losses in revenue would result, however, if the cafeteria plan rules authorized the exclusion of benefits provided through so-called "flexible spending arrangements." Generally, a flexible spending arrangement (FSA) permits an employee to designate some portion of his or her otherwise taxable salary as available for the tax-free reimbursement of specified expenses, such as medical care, legal services, or dependent care assistance. Under an FSA, the employee is assured of receiving, in the form of cash or some other benefit, any portion of the designated amount not utilized for the specified expense.

We have concluded, as proposed Treasury regulations on cafeteria plans reflect, that the statutory provisions granting tax-favored treatment to specified benefits and the cafeteria plan rules themselves do not authorize FSAs. Therefore, a benefit does not fall under any of the applicable statutory exclusions if the benefit is provided through an FSA.

If FSAs were granted favorable tax treatment, employers would be better able to style ordinary compensation as a tax-free reimbursement of their employees' personal expenses. Such expenses are otherwise nondeductible for fax purposes, or, as in the case of expenses for medical or dependent care, entitled to a deduction or credit only under statutory limitations. The effect of granting favorable tax treatment to FSAs would be write out of the Code, at least for employees in cafeteria plans, the existing limits on deductions and credits for a number of personal expenses.

Our revenue estimates indicate that FSAs would have a dramatic effect on the Federal tax base. For the 1984 through 1989 fiscal years (assuming that the exclusion for group legal services is not extended beyond December 31, 1984), we estimate that the $8.7 billion projected revenue loss attributable to cafeteria plans would double to approximately $17 billion if favorable treatment were granted to FSAs.

Welfare Benefit Funds, Including VEBAs.—Generally, the costs of employee compensation, including employer-provided welfare benefits, are deductible by the employer at the time when the compensation is actually provided to the employees. In addition, if an employer sets aside amounts for future employee compensation, income earned on the amounts set aside is included in the employer's gross income for income tax purpose.

Exceptions to these general rules have permitted employers, in certain circumstances, to deduct currently contributions to prefund deferred welfare benefits. The critical advantage to an employer in setting aside funds in VEBAs and other effectively tax-exempt entities is that the income on such funds accumulates on a tax-exempt basis. Generally, neither the employer, the plan or VEBA, or the employee-beneficiaries are taxed currently on the fund's growth.

The historical development of the VEBA rules indicates that the effectively unlimited tax-exemption for VEBAs did not come about in a considered and deliberate fashion. Indeed, before the Deficit Reduction Act, Congress seems not to have appreciated the potentially substantial tax benefits that an employer could derive through a VEBA. Instead, Congress generally viewed VEBAs simply as vehicles through which employees could join together to provide certain welfare benefits for themselves without adverse tax consequences.

Congress originally enacted a statutory tax exemption for VEBAs in 1928. The exemption was available only for VEBAs with respect to which at least 85 percent of the income was collected from members to pay benefits or administrative expenses. Later, in response to the Internal Revenue Service's argument that employer contributions, if in excess of 15 percent of a VEBA's income, destroyed the VEBA's tax-exempt status, Congress provided that employer contributions would be treated as member contributions for purposes of the 85 percent test.

Even after the change in treatment of employer contributions, the 85 percent test, by effectively limiting the investment income in a VEBA to 15 percent of the VEBA's income, prevented employers from using VEBAs to accumulate substantial tax-favored reserves. The Tax Reform Act of 1969, however, in a move apparently intended to restrict the tax advantages of VEBAs, subjected VEBAs to the unrelated business income tax and eliminated 85 percent test; Congress appeared to believe that applying the unrelated business income tax rendered the 85 percent test unnecessary. Under the applicable unrelated business income tax provisions, however, VEBA income was not subject to tax if it was "set aside" to provide permissible benefits. Thus, there were no longer any limits on the amounts that an employer could set aside in a VEBA to pay a permissible benefit, or on the tax-free earnings that could accumulate on the amounts set aside.

In recent years, and especially since Treasury regulations under the Tax Reform Act of 1969 were issued in 1980, the growth in the number of VEBAs has substantially accelerated. According to the IRS, only 7,791 active VEBAs had received favorable IRS determination letters by November 30, 1980. By the end of 1983, however, more than 9,400 VEBAs had received favorable letters. Thus, over 17 percent of the VEBAs in existance as of the end of 1983 have come into existence during the last three of the 55 years for which VEBAs have been tax-exempt. One of the reasons for this recent increase was the enactment of the additional limits—the reduction in the section 415 limits on contributions and benefits and the top-heavy rules—on qualified pension and profit-sharing plans in the Tax Equity and Fiscal Responsibility Act of 1982. VEBAs are subject to neither of these restrictions.

The combination of the current deduction for deferred welfare benefits and the tax-exempt growth of funds set aside for such benefits provides employers with substantial tax benefits. For example, an employer subject to a 46 percent marginal income tax rate generally bears about 54 percent of the cost of providing an employee with a welfare benefit and the Federal government (or taxpayers generally), through the tax system, bears about 46 percent of the cost of the benefit. To the extent that the employer is able to prefund, on a deductible basis, a deferred benefit through a tax-exempt entity, such as a VEBA, a portion of the cost of the benefit will be purchased with tax-exempt income earned by the entity. In such a case, the Federal government (or taxpayers generally) will pick up a greater share of the total cost of the benefit. If the tax-favored prefunding occurs many years in advance of when the benefit is provided, the government's share of the cost will far exceed the employer's share due to the greater accumulation of tax-exempt income. It is important to note that this shifting of costs to the government occurs even though the funding is actuarially sound, and thus the problem is by no means limited to cases involving acturial overfunding.

One way of illustrating the magnitude of this tax benefit is by comparing the after-tax amounts generated if the same amounts are set aside, over a period of years, on a deductible and tax-exempt basis, on the one hand, and on a non-deductable and taxable basis, on the other. For example, assume that a corporation is willing to devote $2,000 at the beginning of each year for 10 years toward providing a benefit at the end of the 10th year. Assume further that the corporation is in the 46 percent tax bracket for each of these years, and that the annual interest rate is 10 percent.

If the corporation uses a VEBA to fund the benefit, it will be allowed to deduct the $2,000 in each year of its contribution to the VEBA. If, however, the corporation merely uses a taxable bank account to fund the benefit, it will be able to set aside in each year only the after-tax value of $2,000, which is $1,080. After ten years of accumulation, the VEBA fund will be $35,062.33, whereas the balance in the bank account will be only $14,587.83. The bank account balance, however, will support a benefit of $27,014.50, which would be financed by the tax savings attributable to the deduction for this benefit (.46 x $27.014.50) and the $14,587.83 account balance. Thus, in this example, funding the benefit through the VEBA permits the corporation to provide a 30 percent greater benefit than funding through the taxable bank account.

The Deficit Reduction Act contains rules that limit the extent to which an employer may use a VEBA or similar entity to provide deferred benefits to employees. Employer deductions to a VEBA for a year are limited to the sum of the benefits provided during the year plus an amount, determined under reasonable acturial standards, to cover benefit claims incurred but unpaid as of the end of the taxable year and to cover projected post-retirement life insurance and medical benefits. Also, to the extent that the reserves set aside in a VEBA or similar entity exceed the permitted reserve limits (without regard to the reserve for post-retirement medical benefits), the income of the VEBA or similar entity will be subject to the unrelated business income tax. Finally, the Deficit Reduction Act limits the levels of benefits that may be provided to employees for purposes of calculating these deduction and reserve limits.

The Deficit Reduction Act also contains rules aimed at limiting the extent to which an employer may use a VEBA or similar entity for unintended purposes. For example, the Act applies eligibility, coverage, and nondiscrimination rules to VEBAs and provides that funds set aside to provide post-retirement life insurance and medical benefits to a key employee of the employer must be credited to a separate account and, to the extent attributable to post-retirement medical benefits, must be counted under the annual section 415 limits as employer contributions to a defined contribution plan. Also, a key employee may receive the promised post-retirement benefits only out of the funds credited to his or her separate account. In spite of the important limits imposed by the Deficit Reduction Act, significant tax benefits remain for employers using VEBAs or similar entities.

HORIZONTAL INEQUITY

The statutory exclusions of fringe benefits from gross income generally are conditioned upon the delivery of the benefits through an employer-sponsored plan. The limitation of tax-favored benefits to employees covered by an employer plan may be seen to discriminate against individuals not so covered. This latter group of non-covered individuals must pay for benefits, such as health care, with after-tax dollars, whereas covered employees are able to purchase the same benefits with pre-tax dollars.

We have prepared data showing the precentage of civilian employees in different income classes who are covered by pension or profit-sharing plans as well as the percentage who are covered by employer-provided group health insurance. This data is summarized in Table II, attached at the end of this testimony. As is reflected in Table II, the percentage of employees covered in the very lowest income categories is substantially smaller than for both the middle and upper income groups.

Comprehensive judgments about the fairness of the existing tax-treatment of fringe benefits should await additional data concerning the distribution of such benefits among income groups. Current data showing significantly smaller employer plan coverage for the lowest paid employees is itself, however, cause for concern. Moreover, it is worth emphasizing that the degree of unfairness attributable to the tax treatment of fringe benefits varies directly with the volume of benefits exempted from tax. As the percentage of compensation paid in the form of tax-favored fringe benefits increases, the issue of how the related tax benefits are distributed among taxpayers takes on increasing importance. Further growth in the volume of tax-favored fringe benefits can only exacerbate already significant concern over taxpayer fairness.

NONDISCRIMINATION AND HEALTH POLICY OBJECTIVES

Nondiscrimination.—A basic justification for providing a tax benefit in the form of an exclusion from gross income is to promote the delivery of the tax-favored benefit to a broad cross-section of employees on a nondiscriminatory basis. It is thus important that effective coverage and nondiscrimination rules apply with respect to each employer-provided benefit eligible for an exclusion from gross income.

Coverage and nondiscrimination rules apply to most tax-favored benefits, such as group-term life insurance, self-insured medical reimbursement plans, group legal service plans, and dependent care assistance programs. However, medical plans provided by an employer under a policy with an insurance company are not subject to nondiscrimination rules. Thus, discrimination in favor of the key and highly compensated employees still is possible in the case of insured health plans.

We also are concerned that cafeteria plans undermine the effectiveness of the statutory coverage and nondiscrimination rules that presently apply with respect to each of the statutory exclusions. These coverage and nondiscrimination rules generally are based on the availability of the particular benefit provided under the plan. In the absence of a cafeteria plan, an availability-type test ordinarily will assure that the benefit is provided to a broad cross-section of employees on a nondiscriminatory basis. Availability-based tests, however, are not effective where employees are free to trade tax-favored benefits for cash or other benefits. Also, the existing coverage and nondiscrimination rules applicable to cafeteria plans generally are not adequate to assure that the basic coverage and nondiscrimination objectives are being protected.

Health Policy Considerations.—The magnitude of the tax benefits available for employer-provided welfare benefit plans may create incentives inconsistent with other important policy objectives. In particular, we are concerned that the generous tax treatment of employer-provided health benefits may have contributed to, rather than helping to contain, increasing health care costs.

Section 106 of the Code provides employees with an unlimited exclusion from gross income for the cost of employer-provided health coverage. Medical care and expense reimbursements received under such coverage are provided with an unlimited exclusion under section 105(b). A primary effect of these provisions is that employees are supplied with extraordinarily generous health benefits, often with no internal controls on costs or utilization of health care. Some employer-provided health plans are so generous that employees bear little, if any, of the cost of routine doctors' visits, hospital care, or medical tests. As a result, the employees tend to overuse doctor and hospital services and medical tests. Such overuse contributes to rising health care costs.

In recognition of the effect on health care costs of the tax treatment of employer-provided health benefits, the Administration has proposed a cap on the health benefit premium that may be excluded from an employee's gross income. There may be additional methods of encouraging employers to introduce more cost-sharing into their health plans and otherwise to reduce private health spending. All parties—Congress, the Administration, and private industry—should work together to target the tax benefits for health plans more effectively.

Furthermore, we believe that health care cost considerations also dictate that favorable tax treatment not be granted to FSAs in cafeteria plans. Because FSAs would allow existing cost-sharing in health plans to be made with pre-tax dollars, the permissive treatment of FSAs would contribute to rising health costs.

We recognize the argument that, in particular situations where an FSA replaces first-dollar coverage, the FSA may introduce a relative incentive for employees not to use health care. However, granting favorable tax treatment to FSAs would permit employees to use pretax dollars to pay for health-related expenses that are currently paid with after-tax dollars. These expenses—cost-sharing under health insurance, payments for services not covered by insurance, and employee contributions to employer-sponsored health plans—are expected to grow to $118 billion by 1990, according to Department of Health and Human Services estimates. If, through the availability of FSAs, a substantial share of the $118 billion were to be financed with pre-tax dollars, demand for health services would be increased and health care cost inflation exacerbated.

More effective and equitable strategies than FSAs are available to aid employers in controlling health care costs. For example, utilization review, second opinions, restructuring of benefits (e.g., to cover noninstitutional care), special service delivery arrangements (e.g., preferred provider organizations), and the promotion of health maintenance organizations are examples of proven and developing strategies for private health cost containment. Also, cafeteria plans without FSAs permit employers to price health benefit options to encourage employees to select the options with additional employee cost-sharing. An employee who selects a lower-option health benefit would then have additional amounts available to purchase other benefits or to receive as cash, which if necessary could be used to pay for health expenses that are unreimbursed due to the higher deductible or co-payment.

We believe thorough analysis clearly indicates that even though FSAs may facilitate a particular employer in attempting to introduce incentives for its employees to reduce excessive use of health care services, the dominant effect of granting permissive tax treatment to FSAs would be to increase health care costs. We thus believe that granting such treatment to FSAs would undercut the effort to formulate an effective health cost containment policy.

TABLE I.—EMPLOYER CONTRIBUTIONS FOR PENSION AND PROFIT SHARING PLANS, GROUP HEALTH INSURANCE, AND GROUP LIFE INSURANCE

[Dollars in millions]

Calendar year	Actual							Projected	
	1955	1960	1965	1970	1975	1980	1983	1985	1989
Pension and profit sharing:									
Amount[1] (dollars)	4,506	7,479	11,317	20,284	42,776	80,791	99,596	124,933	196,585
Percent of wages	2.1	2.8	3.1	3.7	5.3	6.0	6.0	6.4	7.3
Individual income tax liability effect	−1,153	−1,915	−2,574	−5,059	−12,046	−26,579	−30,188	−37,230	−58,582
Group health insurance:									
Amount[2] (dollars)	1,706	3,374	5,890	12,099	21,301	45,380	77,199	90,370	148,420
Percent of wages	0.8	1.2	1.6	2.2	2.6	3.3	4.7	4.6	5.5
Individual income tax liability effect (dollars)	−357	−707	−1,096	−2,469	−4,908	−12,214	−19,629	−22,032	−37,334
Group life insurance:									
Amount (dollars)	561	1,080	1,651	2,891	4,368	6,359	7,592	9,186	13,449
Percent of wages	0.3	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Individual income tax liability effect (dollars)	−126	−243	−330	−634	−1,081	−1,839	−2,022	−2,408	−3,525
Total:									
Amount (dollars)	6,773	11,933	18,858	35,274	68,445	132,530	184,387	224,489	358,454
Percent of wages	3.2	4.4	5.2	6.4	8.5	9.8	11.1	11.5	13.4

[1] Includes federal civilian, state and local government pension contributions.

[2] Actuals are based on Department of Commerce reported data and include employer contributions for short- and long-term disability insurance covering private employees and their dependents for 1955–1970. Actual amounts, for 1975–1983 and Department of Health and Human Services projections for 1985–1989 do not include disability insurance.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, September 14, 1984.

TABLE II.—DISTRIBUTION OF TOTAL CIVILIAN WAGE AND SALARY WORKERS, AND CIVILIAN WAGE AND SALARY WORKERS WITH AN EMPLOYER PENSION PLAN, OR ON EMPLOYER GROUP HEALTH PLAN BY WAGE AND SALARY CLASS [1]

[1983]

1983 Wages	Total wage and salary workers (thousands)	Workers with employer plan			
		Pension		Health	
		Number (thousands)	Percent of workers	Number (thousands)	Percent of workers
Less than $5,000	17,766	1,568	8.8	3,196	18.0
$5,000–$10,000	16,961	4,908	28.9	9,126	53.8
$10,000–$20,000	29,926	17,405	58.2	24,484	81.8
$20,000–$30,000	16,103	12,216	75.9	14,701	91.3
$30,000–$50,000	8,544	6,672	78.1	7,968	93.3
Over $50,000	2,088	1,529	73.2	1,898	90.9
Total	91,388	44,298	48.5	61,373	67.2

[1] Source: 1984 Current Population Survey (refers to 1983 levels). Data shown is self reported and may not completely agree with employer reported data.

Note: A substantial number of workers not covered by their own employers health plan are covered by the health plan of a family member. In 1977 about 73 percent of the civilian noninstitutional population under age 65 was covered by employer health insurance; about 9 percent of the civilian noninstitutional population under age 65 was not covered by insurance.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, September 14, 1984.

Chairman STARK. Could you comment for a moment on whether or not you looked at what the various tax proposals that are floating about would do to both revenue and fringe benefits? For example, the flat-tax-type proposals or value-added tax proposals which could very well tax services and goods, applied to small companies, have you looked at that?

Mr. PEARLMAN. One of the areas we are looking at in connection with our study of fundamental tax reform is both what is the role of statutory provided fringe benefits, and what is the effect on the statutory fringe benefits. You know, one of the things we are doing in connection with our study, Mr. Stark, is developing, which unfortunately is not yet developed, a very substantially expanded weight of data base, which every one, including members and the staffs of the Hill, will be able to call upon to make more intelligent judgments about what the revenue impacts on various statutory changes are, both on the short term when we deal with the targeted legislative proposal and when we are looking at more fundamental issues.

So the answer to your question is yes, we are looking at that. And we hope, and the data base piece is a mechanical problem. We are hopefully within a couple weeks of having a data base. At least, our fingers are crossed that we will, and that that will permit us to do more intelligent revenue analysis than is possible today.

Chairman STARK. Thank you.

Chairman PICKLE. All right, go ahead, Mr. Pearlman. Have you finished with your testimony?

Mr. PEARLMAN. I have finished, yes, sir.

Chairman PICKLE. Mr. Pearlman, have you, before you conclude, made any recommendations about actions for the Congress to take?

Mr. PEARLMAN. No, sir; at this point we have not. We are looking, obviously, as Treasury generally does, at what things continue to need to be done. Now, we have in our testimony mentioned a few general things. We are interested in the subject of nondiscrimination. We are interested in the subject of fairness. Is the current system fair? But two things have occurred that would suggest to us that specific recommendations perhaps might not be appropriate at this point. One is we are taking a hard look at the subject of fringe benefits in connection with our fundamental tax reform study. The second thing is the Congress took some very significant actions——

Chairman PICKLE. Mr. Pearlman, pardon me. You said you are taking a hard look at fringe benefits with respect to the package you might offer. Did I understand you?

Mr. PEARLMAN. We believe that part of our commitment in responding to the President's directive to give him some recommendations on fundamental tax reform is to look at the subject of statutorily provided fringe benefits in a continuing income tax, or, if our system were to change. And in that regard we are looking at the current system of the delivery of fringe benefits.

Chairman PICKLE. Can you tell the committee at what point you might make such recommendations or analyses, further analyses to this committee or the Congress?

Mr. **Pearlman**. I would think realistically, Mr. Chairman, unless we are called upon earlier, that the most likely time that we would be making specific recommendations to the Congress and whether we will or not, you know, at this point I just can't tell, would be in connection with the budget. But I think, absent additional hearings, that I would think certainly not on the very short term.

Chairman **Pickle**. What I am trying to establish is that you do feel that there is discrimination that should be corrected; that there is a loss of revenue; and that the tax base is being eroded. And that these matters ought to be corrected. And assuming the continuation of this administration, you would probably make a recommendation to make changes after the first of the year?

Mr. **Pearlman**. Well, no, I just can't say that because I just don't know. I think that at this point, because of the work we are undertaking now, coupled with the fact that we don't have, and I don't think anyone does, in hand what the real implications of the 1984 legislation are. I think at this point I am simply not in a position to tell you that some 6 months from now we will be in a position to make recommendations. We know we have got a commitment to Congress that was imposed upon us by the 1984 legislation to make a report to the Congress in the flexible cafeteria plan spending by next April, and we will certainly do that.

Chairman **Pickle**. I understand that all things in general, since your testimony points out that there is discrimination, and some unfairness, that there is a—that the employers are taking large deductions and that some changes should be made, that we can anticipate a recommendation at some point for correction of these things. So whenever that occurs, we would be of course interested in having it.

Let me ask you for my information. On your page 9 you said that nondiscrimination rules do apply to life, group health, group legal services, and so forth. However, medical plans provided are not subject to nondiscrimination rules. Why is that?

Mr. **Pearlman**. Mr. Chairman, I just can't answer you. I just don't know the answer to that question. I was not around at the time of that legislation, and I don't know why insured plans were excepted. That is one of the areas, however, that we want to look at and we want to try to get handle on what the effect of that is on the broad delivery of tax-favored fringe benefits. But I simply can't answer your question. I don't know.

Chairman **Pickle**. Perhaps we ought to ask ourselves why that is, to observe this is the last big area which has not been covered. Let me ask you one question that has been submitted to me to ask. We are going to receive testimony shortly from the HHS and SSA. We anticipate, based on the testimony we expect to receive, learning how Social Security tax rates could be reduced without decreasing revenues under various assumptions of different amounts of fringe benefits being included in Social Security wage base. Maybe this is what Secretary Regan has referred to as changes in Social Security.

Now, we requested this information on tax rates with all fringe benefits being included in the wage base, without further increase in fringe benefits and other projections. So I am wondering if you could provide us with similar-type information on the effect of fringe benefits on income tax rates. For example, if revenue were held constant, how much could tax rates be reduced if all fringe benefits were included in the income tax base? And what could be done to rates if there were no further increases in nontaxable fringe benefits? I would like for you to give us some information when you can, as quickly as you can.

Mr. PEARLMAN. Certainly. We will be happy to provide that.

TREASURY RESPONSE

The exclusion from the individual income tax base of employer contributions to pension and profit sharing plans, group health insurance, and group life insurance resulted in a reduction in 1983 Federal income tax liability of $53 billion computed at 1983 tax rates. Had these items been included in the individual income tax base, the current law level of receipts could have been maintained with an average reduction in rates of about 12 percent.

Chairman PICKLE. The Chair would recognize Mr. Duncan now for any questions that he might have.

Mr. DUNCAN. Thank you, Mr. Chairman.

Mr. Pearlman, in your study of fringe benefits, have any general conclusions been reached as to the amount individual tax rates could be reduced by increasing the kinds of fringe benefits that are taxed?

Mr. PEARLMAN. No, Mr. Duncan. Really, that is the reason we did not provide that data this morning. One of our hopes is that by the expanded data base we are working on that we will be better able to make those judgments. At this point we simply don't have those data.

Mr. DUNCAN. Does Treasury view the tightening of the fringe benefits nondiscrimination rules as a means of limiting fringe benefits?

Mr. PEARLMAN. Oh, I think clearly the—I don't think it would be fair to say that we view the nondiscrimination rules—I mean they will have that effect. I don't think we view the nondiscrimination rules as necessarily a vehicle that should be used to limit them. I think we view the nondiscrimination rules as a, simply a condition that should be applied as a matter of fairness and equity to any statutory fringe benefits that are provided by Congress. If, for example, we were to suggest to you the expansion of the nondiscrimination rules to a particular fringe benefit, it would not be for the purpose of cutting down revenue loss, for example. It would be because we think it is fair that these fringe benefits be provided on a nondiscriminatory basis.

But we do believe that the discrimination rules are important and that they should continue to apply to all statutory fringe benefits. To the extent they don't apply, we think those are areas we should look at and maybe indeed we will be coming back to you making some suggestions in that area.

Mr. DUNCAN. Do you have any idea of what period of time will have to elapse before Treasury gets a fairly accurate reading of how the fringe benefit rules in the 1984 act are actually working?

Mr. PEARLMAN. Realistically, if you want really reliable data, the only source of data that we have generally available to us that is really reliable is tax return data. Now, if we wait that long we are talking about some years. Our hope is that we will be able, through data that is voluntarily provided by the industry, interested industry groups, and through data which we hope that the Internal Revenue Service can develop that is other than pure tax return data, that we may be able to provide you some information in shorter than the normal period of time.

For example, now we have good tax return data through 1981 but nothing that is very firm beyond that. So you can see there is a lapse of a few years. And if we wait that long it is going to be awhile.

Mr. DUNCAN. Thank you very much, Mr. Pearlman. Thank you very much, Mr. Chairman.

Chairman STARK. By referral I was asked to inquire of you, but I think the answer to this question is self-evident. It said there is concern that if you limit the amount of tax-free employer contributions to a health plan, it would result in reducing health benefits. The guess, I would say the other side of that question is, if you limit the amount, you raise the cost, either way, raise costs or limit benefits. Is there any other option in that area?

Mr. PEARLMAN. Well, I would really like Mr. Helms to comment on this, too. So I will give you my uninformed comment. That is it seems to me that there is another option. That is how employers tailor their plans. Maybe we are saying the same thing. Raise the cost, but if employees have to—it seems to me that employers and employees have to recognize that it can't be a free ride. That incurring health care costs just can't be a free ride to anyone, because it in fact is not. For me, if I am the employee, it will be raising my costs. If there is a higher deductible, there is a higher copayment, that means the cost may go up to me. It may not though. It may mean that without being irresponsible, and I think that is important, that we are not forcing employees to forgo needed health care, that employees can make a judgment that health services that are really not needed, that are luxurious or duplicative, could be forgone without increasing costs. That it just forces people to make better judgments.

And I think one of the things we are concerned about in terms of the cafeteria plan, for example, is that employees are not forced to make that decision.

Chairman STARK. So what you are saying is, they may discriminate or be more discriminatory in how they use their benefits if it costs them something?

Mr. PEARLMAN. That is correct.

Chairman STARK. That I think is a halfway post, between either providing fewer services or increasing cost for the existing ones. And I would share your opinion that, obviously, having it just open ended and—tends to generate things like I suppose cosmetic surgery and dentistry and a lot of things that are likely to advance in the cosmetic world we live in, but may not be something the Federal Government wants to pay for.

I think our next witness, then—does anyone else have any questions? Yes. Mr. Secretary, while you are perfectly welcome to stay and participate, Secretary Pearlman, we could excuse you and call on Dr. Robert Helms, Acting Assistant Secretary for Policy and Evaluation, Department of Health and Human Services, Mr. Ballantyne, Chief Actuary of the Social Security Administration.

Are you two testifying separately?

STATEMENT OF ROBERT B. HELMS, ACTING ASSISTANT SECRETARY FOR PLANNING AND EVALUATION, DEPARTMENT OF HEALTH AND HUMAN SERVICES, ACCOMPANIED BY BRUCE STEINWALD, ACTING DEPUTY ASSISTANT SECRETARY FOR HEALTH POLICY

Mr. HELMS. Thank you, Mr. Chairman.

I have with me Bruce Steinwald, Acting Deputy Assistant Secretary for Health Policy.

It is a pleasure to be with you today and to represent the Department of Health and Human Services and talk about employer-provided fringe benefits. I will focus, as you said, primarily on the topic of employer-provided health care benefits.

The availability of employer-provided health insurance protection has contributed to the welfare of most Americans. According to the best data available, 80 percent of the nonaged population are covered by private health plans, of which 82 percent were group plans. The predominance of employer-provided health insurance financing must be recognized as a success story of major proportions.

Indeed, we tend to forget how employer-employee financed group health plans have shaped national policy. In 1965, we took the model of a private health insurance plan for the model of medicare, and most of the proposals over the years for serious reform have been based on a system of private employer-provided health insurance. In other words, we have never considered other types of models, such as those they used in Europe.

Eventually, we realized that our diverse and dynamic system of private insurance was not just a suitable model, but was in fact a superior system to a monolithic national health insurance scheme.

But having made that important choice, we were left with some unresolved issues. The dominant role of group health insurance financing is partly an evolutionary response to preferential tax treatment. The cumulative influence of tax incentives led to plan designs that went well beyond financial protection. Plans were expanded to the point of providing coverage paying for routine, budgetable medical bills, often with no cost-sharing or other controls on excessive use of services. In an environment of liberal third-party financing, hospitals and physicians expanded services utilization and accelerated the pace of medical technology.

And so it was that insurance financing in the private sphere, already recognized as a great and beneficial institution, came to be recognized also as contributing to our severe and continuing medical expenditure inflation. As we know only too well, this inflation has added to fiscal imbalance, reduced access to care by those not adequately insured, distorted production and consumption incentives, and diverted more and more household income from other forms of consumption.

The administration made health care cost inflation a first priority matter. Policy recommendations have focused on reforming incentives rather than regulating behavior. Two key legislative proposals aimed at incentives were developed early in this administration. A plan for prospective payment of hospitals under medicare has been enacted and is already producing constructive results. We also proposed a limitation on the amount of income employees could receive tax-free in the form of health insurance.

Under pressure from rising health care costs, and realizing that neither Congress nor the administration would support a regulatory solution, employers proceeded to adopt a variety of innovative strategies for containing costs. One of these is cost sharing.

Cost sharing is rapidly being introduced and extended, often in the context of cafeteria plans offering choice among different levels of coverage. According to a recent Hay-Huggins survey, about one-third of a broad sample of private firms had recently increased deductibles; another third were considering such an increase.

We know from many types of evidence—most recently and decisively from the Rand Health Insurance Study sponsored by my office—that cost sharing significantly affects utilization of services, a result that is repeatedly confirmed by the experience of employer plans where deductibles have been instituted or raised.

Second surgical opinions, private utilization review and monitoring of physician treatment patterns are all proving effective in cutting claims cost.

Innovative health care financing and delivery systems, such as preferred provider organizations [PPO] are continuing to proliferate. Enrollment in health maintenance organizations [HMO's] a proven efficient alternative to traditional insurance financing of health care, is growing at over 15 percent per year.

I might add that our recent proposed regulations that would open up the HMO's to the medicare population we think will increase the rate of HMO growth.

We can say that in the 1970's the degree of comprehensiveness for employer-provided health care reached a peak. The 1980's are shaping up as a period of growing discipline in plan design and management. This is a constructive trend that I would like to see continue.

As constructive as this direction of movement appears to be, it does not portend immediate solutions to longstanding problems. Indeed, new problems seem to come along as fast as old ones abate. The issue of flexible spending accounts [FSA's] has already been introduced by Mr. Pearlman. I would like to elaborate on that subject.

As an initial point, let me emphasize the difference between a cafeteria plan—recently referred to also as a flexible benefit plan—and the flexible spending account. To illustrate the distinction, consider a prototype cafeteria plan. It might offer employees a choice among standard comprehensive benefits, a low option with a sizable deduction, and an HMO. It might also offer other benefits such as a deferred income plan and dependent care. The total value of benefits would be set by the employer but might be augmented by an employee contribution.

Flexible spending accounts, developed by some companies and their consultants early in this decade, extended the above concept by allowing employees even wider latitude in determining the proportion of their incomes devoted to nontaxable fringe benefits. Such plans were often packaged with increases in cost-sharing under the employer-sponsored health plan. The essential attribute of a flexible spending account is the opportunity it affords the employee to transform the financing of out-of-pocket medical expenses, and sometimes other purchases from after-tax income to before-tax income.

Testimony by the Department of the Treasury has stressed the potential revenue effects of widespread adoption of FSA's. Recent IRS rules restrict the operation of FSA accounts. Most importantly, no cash refund or carryover is permitted except for some plans that are temporarily grandfathered, and under current rules a flexible spending account can operate only as part of a cafeteria plan. But the cafeteria plan need not include the essential features of a flexible spending account.

For this reason, we should be careful to discriminate between effects attributable to FSA's and those associated with cafeteria plans. This distinction is especially important when considering health policy issues relating to tax reform and incentives.

Concern about the potential revenue impact of FSA's is based on a projection of household expenses that could be channeled through FSA's barring specific restrictions. It must be remembered that not only a wide class of employee expenses but also employee contributions for health insurance plan premium payments could be paid from such accounts. Out-of-pocket health-related expenses of employees with potential access to FSA's are now preliminarily estimated to be over $60 billion and will grow to $100 billion by 1990. Employee premium contributions are $20 billion and will be over $35 billion in 1990.

Despite the potential for FSA's to be used as a tax-sheltering device, it is possible that under certain circumstances there may be some benefits to be derived from the invention of FSA's. Under the obvious tax-shelter features of FSA's there exists a basically good idea—the combination of increased front-end cost sharing on health benefits and a specific employee-controlled account guaranteeing availability of funds to pay medical bills engendered by that cost sharing.

Results from the Rand experiment and other evidence show that front-end cost sharing reduces spending on health services with no appreciable effect on employee health. Health spending reductions affect income tax revenues in two ways: reduced corporate expenses for health care means higher corporate profits and taxes; and reduced employee compensation in the form of health benefits means more dollars are available for taxable wages.

The question remaining about FSA's is how much simple tax sheltering might be expected for any given set of qualifications on use. In addition to the tax revenue losses that could occur, we must also recognize that allowing employees to pay out-of-pocket expenses with pretax dollars makes those purchases cheaper, and so encourages utilization of the services thus purchased. This relationship could cancel possible constructive effects mentioned above.

To resolve these issues, many questions must be answered. Recognizing the need for more information, as you know, Congress mandated further study of the issues as a provision of DEFRA. My office, with the cooperation of the Treasury Department, has undertaken this study. We expect to report the results by April 1, 1985.

Before concluding, I would like to touch on another policy issue inherent in the distribution of employer-provided health benefits—the issue of equity. Employer-provided benefits are given preferential tax treatment, and the advantages bestowed by this treatment increase with income. According to available data, employer-premium contributions for health benefits rise from an average of about $800 for covered workers in the lowest 15-percent-income bracket to $1,300 for workers in the top 40-percent bracket. The higher paid workers have more to gain by receiving compensation in the form of nontaxed benefits because their income tax brackets are higher.

In stark contrast, some workers—most often those in marginal, part time, and temporary jobs, the self-employed, and workers between jobs—have no coverage at all. These workers tend to be low income but they receive no benefit whatsoever from the current preferential tax treatment of health insurance.

I have touched on three problem areas in employer-provided health insurance: inflation, the flexible spending account phenomenon, and equity. It is only appropriate to mention again a legislative initiative that addresses all these. That is the proposal to place a limit on the total amount of income that employers can pay in the form of tax-free health insurance coverage.

The motivating rationale for such a limit remains, as always, to reduce the distorting effect of the tax preference leaving employment groups to develop cost-containment innovations that suit their own needs. It is not a punitive tax on benefits, but rather an effort to make the tax law more neutral in the choice between added wages and added benefits. Such a limit would be enormously helpful in accelerating the trend to more efficient health plans that I summarized earlier. It would facilitate the search for ways to capture the advantages of flexible spending accounts without the adverse effects. And it would contribute to fairness.

In closing, I will reiterate my admiration for the dynamic world of employer-provided health benefits. The achievements in this area are both evidence of the genius of the private sector and a continuing challenge to public policy. The problems that have been associated with the growth of employer-provided health care are transient effects that may be controlled through a balancing of incentives.

In the interest of retaining the advantages of private-sector responsibility, I hope to see the goal of Federal policy remain that of making employer provision of health and other fringe benefits even more efficient, fair, and conducive to a stable economy.

I would be glad to try to answer your questions, Mr. Chairman.

Chairman STARK. Thank you, Doctor.

I gather that you share the Treasury's view that it would be a good matter of equity to enforce the salary nondiscrimination rules in the area of health benefits or health programs, medical-care programs?

Mr. HELMS. You mean the question you put to Mr. Pearlman about nondiscrimination?

Chairman STARK. Yes; it is one of the major areas in fringe benefits where we don't say the plan has to be the same for all levels of salary, and can't discriminate on the basis of income.

Mr. **Helms**. Let me make a couple of points about that, Mr. Chairman.

In particular, table 2—first of all, I would go along with Mr. Pearlman. I think we would like to consider that these nondiscrimination rules be applied to the health-care sector. But, having said that, I am personally not aware that they have been presented as any particular problem. I think the evidence is that most employer-provided plans are made available across the board to employees of each company.

The problem addressed in Mr. Pearlman's table 2 is that you have a low percentage of the people in the lower income brackets having health coverage. I don't think they would be greatly affected by nondiscrimination rules. That is mostly a phenomenon of a lot of employed people who work for small firms; they are simply not insured.

We have found that over half the noninsured people are full-time workers and their dependents. I just don't think the application of the nondiscrimination rules would directly affect that problem.

Chairman **Stark**. No, I don't think it would, either. It would probably raise a little revenue.

There probably is a fairly widespread practice in smaller groups where the owners or highly paid executives have substantially more benefits than the average worker, but that is not to say the average worker's benefits are not good. They may not take care of orthodontia and fitness center trips and cosmetic surgery and the like, hair transplants and some other more——

Mr. **Helms**. Gymnasiums.

Chairman **Stark**. No. Gymnasiums now have to be on a nondiscriminatory basis.

Mr. **Helms**. OK.

Chairman **Stark**. Mr. Duncan.

Mr. **Duncan**. I have no questions, Mr. Chairman. Thank you.

Chairman **Stark**. Thank you.

We look forward to working with you on this matter.

Mr. **Helms**. Thank you.

Chairman **Stark**. Our next witness is Harry Ballantyne, Chief Actuary, Social Security Administration.

Welcome to the committee, Mr. Ballantyne. Your entire statement will appear in the record. You may proceed to summarize it, expand on it, in any fashion you prefer.

STATEMENT OF HARRY C. BALLANTYNE, CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION, DEPARTMENT OF HEALTH AND HUMAN SERVICES, ACCOMPANIED BY BRUCE SCHOBEL, ACTUARY, SSA

Mr. **Ballantyne**. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittees, I am Harry Ballantyne, Chief Actuary of the Social Security Administration. I have with me Bruce Schobel, one of my assistant actuaries.

I am happy to be here today to discuss with you the effects of employer-provided fringe benefits on Social Security program financing and benefits. My prepared statement is quite short and covers essential points, so I will just present it.

Chairman **Stark**. Please proceed.

Mr. **Ballantyne**. For purposes of this statement, "fringe benefits" refers to that portion of an employee's total compensation that is not covered for Social Security purposes.

As the subcommittees are aware, the proportion of employee compensation represented by nontaxable fringe benefits has grown from about 8 percent in 1960 to about 16 percent this year. From a Social Security perspective, the growth of fringe benefits brings about a concomitant erosion in the proportion of total employee compensation represented by wages. This proportion has thus declined over the years, from 92 percent in 1960 to 84 percent this year. Based on the intermediate—Alternative II-B—assumptions of the 1984 OASDI Trustees Report, we project this figure will decline to about 66 percent by 2060—about 75 years from now.

Based on the wage and productivity assumptions in Alternative II-B, we project that, over most of the next 75 years, wages will grow at an average annual rate of 5.5 percent. Total employee compensation, however, is projected to grow at an average annual rate of 5.8 percent. If the rate of growth in fringe benefits outpaces the growth in wages to the extent assumed in the 1984 Trustees Report, by the year 2060 fringe benefits will represent some 34 percent of total compensation.

I am submitting for the record a graph showing these trends as well as other projections based on the subcommittees' requests.

This projection, under present law, reflects the assumption that total wages, as a percentage of total compensation, will decline at a long-term rate equal to about three-fourths the rate of decline over the last 30 years. In part, this slower rate of decline in the future reflects the actions taken by the Congress since 1980 to alter the tax treatment of fringe benefits.

As you know, in accordance with the recommendations of the National Commission on Social Security Reform, the 1983 Social Security amendments contained a provision subjecting to Social Security taxes payments into section 401(k) cash or deferred arrangements. Such arrangements are among several kinds of fringe benefits that are now treated differently for purposes of the Social Security payroll tax and for the Federal income tax. Also, the Deficit Reduction Act of 1984 provides that any fringe benefits not specifically excluded by statute are taxable for income tax and Social Security tax purposes.

The importance of the erosion in wages as a percentage of compensation, for purposes of Social Security, is that, because the OASDI program receives most of its income from a tax on covered wages, a decline in the proportion of total compensation subject to payroll taxes can cause income to the program to be lower than it otherwise would be and thus affect the level of the tax rates necessary to fund the program adequately—the same is true for the hospital insurance program.

In addition, if an income shortfall results from continued faster growth in nontaxable fringes, the burden of making up that shortfall would fall not only on those workers who benefit from the additional fringes but also on those workers whose nontaxable fringe compensation does not keep up with the general rise.

Finally, as the mix of covered wages and noncovered fringe-benefit compensation changes, workers have a smaller proportion of their total compensation included for purposes of computing their social security benefits. Thus, workers and their families stand to get lower social security benefits when they retire, become disabled or die than they would if the amounts credited to them as earnings for social security benefit purposes more closely resembled their total compensation package.

In this connection, I am submitting for the record illustrative examples of the effects of future growth in nontaxable fringes on the amounts of employees' social security taxes and benefits, prepared at your request. These figures can vary considerably, depending on the underlying assumptions.

Before I discuss the long-range social security cost effects of the tax and benefit status of fringe benefits, it is important to refer to technical matters that may well have significant impact on any long-range cost figures.

In estimating the financial effects, we have assumed that any extension of social security coverage to fringe benefits that are currently exempt from taxation would provide for the inclusion of those earnings for benefit-computation purposes, as well. This assumption, however, raises a number of other technical questions.

The most important among these is the question of whether any taxable fringe benefits—that is, fringe benefits that would be subject to social security taxes and creditable toward social security benefits—would be included in the annual calculation of the average wage series that is used for purposes of indexing covered earnings, the earnings base, the retirement earnings test exempt amounts, and the benefit-formula bend points.

Including a broader compensation base in these computations would raise future benefits for today's workers, even for those who get no fringe benefits. Such extra benefits would significantly offset any long-range gain in trust fund income. Consideration of such effects could lead to important policy decisions on the part of the Congress and the administration, as to the proper definition of the wage series to be used for indexing.

Let me now turn to specific estimates of the effects of including currently nontaxable, fringe-benefit compensation in taxable income for social security purposes. I will respond to the subcommittees' requests in the order in which they were stated in Chairman Pickle's letter of September 11.

I might note that the subcommittee requests were phrased in terms of the long-range tax rates necessary to keep trust fund ratios at currently projected levels over the long range if nontaxable fringes were made taxable for social security purposes under four assumptions with respect to the relative mix of taxable wages and nontaxable fringe benefit compensation.

First, if nontaxable fringe benefits as a proportion of total compensation were to be maintained at 1984 levels, the long-range OASDI actuarial balance would increase by 0.50 percent of taxable payroll—implying that a reduction of 0.50 percentage points could be made in the average combined employee-employer OASDI tax rate over the normal 75-year valuation period.

Second, if, as a percentage of total compensation, nontaxable fringe benefits were allowed to grow at half the rate implicit in the Trustees Report Alternative II–B assumptions, the long-range OASDI actuarial balance would increase by 0.25 percent of taxable payroll.

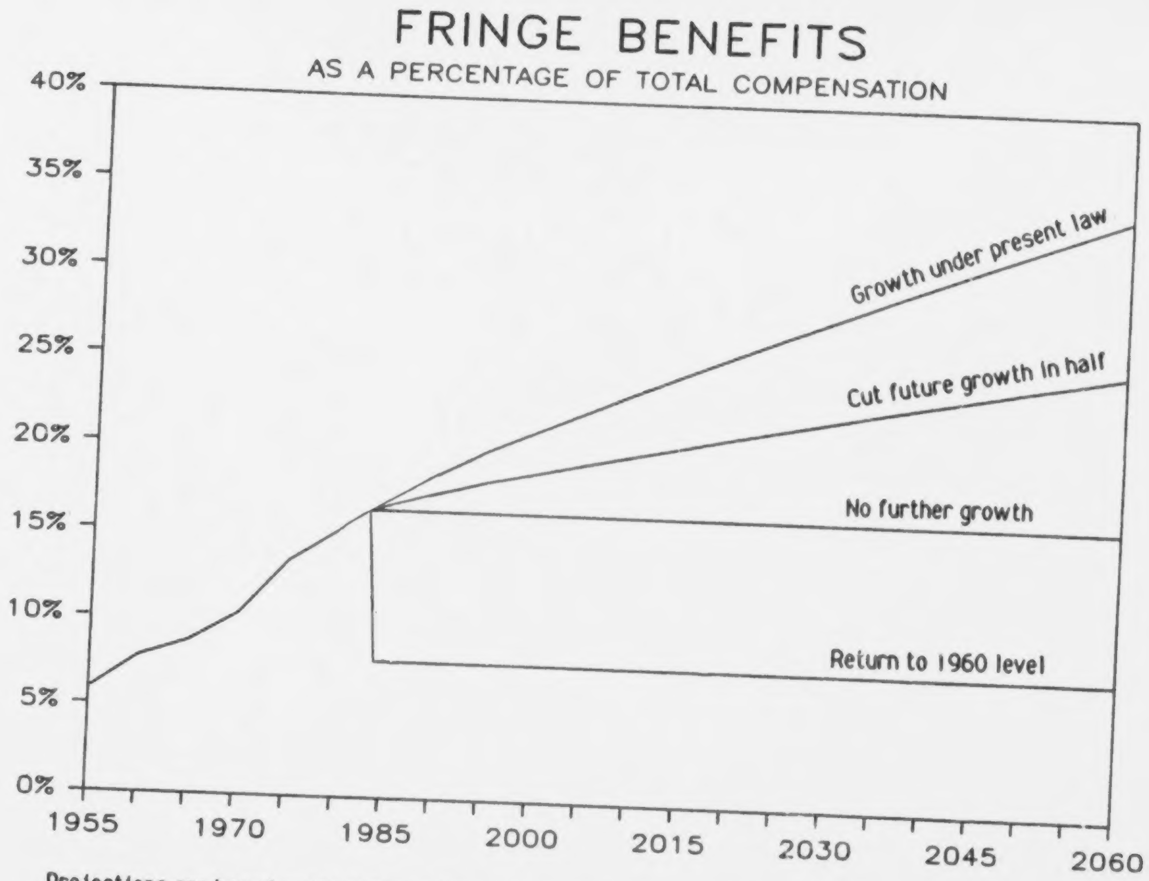
Third, if nontaxable fringe benefits were to be brought down to their 1960 level, as a proportion of total compensation, and were kept at that level, the long-range OASDI actuarial balance would increase by 0.65 percent of taxable payroll.

Fourth, if all current and future fringes were to be taxable for social security purposes, the long-range OASDI actuarial balance would increase by 0.80 percent of taxable payroll.

In conclusion, let me return to the policy matters I referred to earlier and note that these long-range savings would be higher if currently nontaxable fringes that would be subject to social security taxes and creditable for benefits were not to be included in the computations of the average-wage series used for wage indexing. I am not taking a position on whether such exclusion would be desirable, but rather wish to highlight this area as one that may need further investigation.

That concludes my prepared statement. I will be happy to respond to your questions.

[The attachments to the statement follow:]



FRINGE BENEFITS

AS A PERCENTAGE OF TOTAL COMPENSATION

Projections are based on the intermediate (alternative II-B) assumptions of the 1984 Trustees Report.

Table 1

Illustrations of additional contributions and benefits for employee with "average" earnings

Assuming no further growth in taxable fringe benefits as a percentage of compensation

	Additional employee contributions		Additional initial monthly benefits	
	OASDI	OASDI-HI	Primary insurance amount	Family maximum
A. Retirement				
1. Age 60 in January 1984, retires at age 65 in January 1989	$65	$81	$3.30	$6.20
2. Age 45 in January 1984, retires at age 65 and 4 months in May 2004	1,705	2,104	93.50	170.10
3. Age 21 in January 1984, retires at age 67 in January 2030	22,345	27,572	868.50	1,570.40
B. Disability				
1. Age 21 in January 1984, disabled at age 30 in January 1993	240	297	29.50	44.20
2. Age 45 in January 1984, disabled at age 55 in January 1994	306	379	34.50	51.70
3. Age 21 in January 1984, disabled at age 55 in January 2018	7,636	9,422	392.20	588.30
C. Survivor				
1. Age 21 in January 1984, dies at age 30 in January 1993	240	297	30.50	54.80
2. Age 45 in January 1984, dies at age 55 in January 1994	306	379	34.50	63.40
3. Age 21 in January 1984, dies at age 55 in January 2018	7,636	9,422	392.20	714.10

Social Security Administration
Office of the Actuary
September 17, 1984

Table 2

Illustrations of additional contributions and benefits for employee with "average" earnings

Assuming one-half of the growth projected under present law in taxable fringe benefits as a percentage of compensation

	Additional employee contributions)		Additional initial monthly benefits	
	OASDI	OASDI-HI	Primary insurance amount	Family maximum
A. Retirement				
1. Age 60 in January 1984, retires at age 65 in January 1989	$33	$41	$1.50	$2.20
2. Age 45 in January 1984, retires at age 65 and 4 months in May 2004	836	1,032	46.20	83.40
3. Age 21 in January 1984, retires at age 67 in January 2030	10,813	13,342	419.10	758.50
B. Disability				
1. Age 21 in January 1984, disabled at age 30 in January 1993	118	147	14.30	21.40
2. Age 45 in January 1984, disabled at age 55 in January 1994	151	187	16.80	25.20
3. Age 21 in January 1984, disabled at age 55 in January 2018	3,720	4,591	190.50	285.80
C. Survivor				
1. Age 21 in January 1984, dies at age 30 in January 1993	118	147	14.90	25.60
2. Age 45 in January 1984, dies at age 55 in January 1994	151	187	16.80	31.00
3. Age 21 in January 1984, dies at age 55 in January 2018	3,720	4,591	190.50	346.30

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Chairman **Stark**. Thank you very much, Mr. Ballantyne.

On your Table 1, do some back-of-the-envelope arithmetic, if you will, with me. Under "A. Retirement," a person 45 years old—take that one—he retires at about 20 years, and under your table that would mean they would put in approximately $100 a year in additional employee contributions under FICA.

Am I interpreting that right—somewhere between $1,705 or $2,100, if you include health insurance?

Mr. **Ballantyne**. Yes; I think that is right.

Chairman **Stark**. So, in round figures, you can say a man today, or an employee today—single employee, I gather this is—if they paid an additional $200, which is the FICA tax there that they are not paying because of their fringe benefits being tax-free, they would have about—if you take the average for the primary amount—somewhere between $90 and $170—say, $130 a month, to pick a middle figure. So for paying $200 a year for 20 years——

Mr. **Ballantyne**. About $100 a year?

Chairman **Stark**. I beg your pardon?

Mr. **Ballantyne**. Wasn't it $100 a year, Mr. Chairman?

Chairman **Stark**. No. It is about $200—excuse me. Yes, $100 a year, yes.

You end up getting $100 a month increase in your annuity, as it were.

Now, can you tell me roughly what it would cost somebody to buy an annuity to provide, let's say, $1,400 a year or $1,500 a year, or $1,000—whatever is easy to do—and make 20 payments? I have no idea. But I would imagine substantially more than $100 a year.

I say this only because I think many times people in my town meetings will say, "I can take this money and invest it and make so much more than social security, if you let me go to E.F. Hutton."

I am guessing; you probably have to earn 30 or 40 percent return year-in and year-out on your money tax-free to come anywhere close to getting these kinds of benefits.

I understand the employer is paying in as well, but I am just talking from the standpoint of the social security beneficiary. It is a fabulously good deal for people. And I would wonder if they wouldn't be encouraged—if they had any idea how much this would return to them—to just almost voluntarily go ahead and pay the increased FICA on their fringe benefits.

I am looking at this table correctly, am I?

Mr. **Ballantyne**. Yes; that is right. I agree with you that the return would be much higher than for a private annuity.

Chairman **Stark**. And be better for the system, would it not, because of the other side of the issue—that you have the employer's contributions?

Mr. **Ballantyne**. It would be better for the system because there would be a long-range gain.

Chairman **Stark**. So, in effect, by taxing, as far as FICA, we would be giving, by any commercial standard, outstandingly generous, almost unobtainable benefits. I mean, in the realm of commercial practice, you couldn't buy a benefit that begins to approach that.

Mr. **Ballantyne**. Right.

Chairman **Stark**. Secondly, we would be helping the economic viability of the system.

Mr. **Ballantyne**. Right.

I think it is difficult to compare with private annuities, but I think that if a reasonable and well-balanced analysis of that issue were to be made you would have to take account of several things, such as the duration of time during which benefits would be received, interest rates, and cost-of-living-adjustment increases in benefits, as well.

I think that by and large the comparison between how much a worker pays in increased contributions—the total amount—and the total benefits he might expect to receive, would be on the average somewhat less than it is under present law, which is——

Chairman **Stark**. Doesn't this example that we are talking about—or this phenomenon—impact favorably the low income worker far more? Your figures are based on an average salary. But if we take those people that are below $15,000 or below $12,000, whatever the average is, isn't the effect on their benefits even greater?

Mr. **Ballantyne**. Right; because of the weighting of the benefit formula.

Chairman **Stark**. And the maximum is at $30,000——

Mr. **Ballantyne**. $37,800.

Chairman **Stark**. Somebody way above that would be getting proportionally less.

So if we were to tax or apply the FICA tax to these fringe benefits, it would be heavily weighted in favor of the lowest income workers?

Mr. **Ballantyne**. There would be somewhat more weighting towards them. A worker with more than the maximum wouldn't be affected because I would assume the wages would be counted first, and he is already paying the maximum. So he would have to be under the maximum.

Chairman **Stark**. So it would not be overly progressive in terms of their burden.

Mr. **Ballantyne**. Right.

Chairman **Stark**. Well, Chairman Pickle unfortunately had some—not unfortunately for the rest of the world, because he has a speech to make on the floor which I think he is delivering about now, or has just delivered—he wanted to emphasize particularly that last question, that there is a tremendous benefit to the employees, and that benefit is very progressive as to its benefits. And I think I am adequately stating that that is his concern; that people are losing, one, a tremendous opportunity; two, the cost is minimal; and three, I think it is safe to say in behalf of Chairman Pickle that it would be a great benefit to the survival or the soundness of the trust fund if we add what seems now to be kind of dealing penny-wise and perhaps even pound-foolish—I know there are people concerned that one fringe benefit may be singled out over another to pay taxes on. But I think that in the interests of the working people of this country they would be clamoring to get FICA taxes applied to every fringe benefit they could find.

Wouldn't that make economic sense if they were just doing it in a rational sort of approach to their own economic health? They can't buy, as near as I can tell—and I really would appreciate it if you would take one of these examples and say, if you assume the average worker you can assume the average marginal bracket, which is somewhere around 30-some percent, and take it out as to what they would have to earn to accomplish this as individuals. I still think there are people out there who think they can do better; that social security to them is just not a good buy. I think we would do them all a favor if we could dispell that myth.

So in behalf of Chairman Pickle, I thank you for preparing this information. And I would like to look forward to working with your office to get this even into simpler language that the average wage-earner like myself can understand.

Mr. Duncan.

Mr. DUNCAN. I have no questions. Thank you, Mr. Chairman.

Chairman STARK. Thank you very much for your excellent testimony. We appreciate your appearance.

Mr. BALLANTYNE. Thank you, Mr. Chairman.

Chairman STARK. The committee will stand in recess until 10 o'clock tomorrow morning.

[Whereupon, at 12:33 p.m., the subcommittees recessed, to reconvene at 10 a.m., Tuesday, September 18, 1984.]

DISTRIBUTION AND ECONOMICS OF EMPLOYER-PROVIDED FRINGE BENEFITS

TUESDAY, SEPTEMBER 18, 1984

House of Representatives, Committee on Ways and Means, Subcommittee on Social Security and Subcommittee on Select Revenue Measures,

Washington, DC.

The subcommittees met at 10:10 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the Subcommittee on Social Security) and Hon. Fortney H. (Pete) Stark (chairman of the Subcommittee on Select Revenue Measures) presiding.

Chairman Pickle. The Chair calls to order the joint Subcommittees on Social Security and Select Revenue Measures, for consideration of employee benefits. When we opened the hearing yesterday we asked for any preliminary remarks by individual members. I am pleased to recognize, before we start our hearings this morning, the distinguished gentleman from Hawaii, Mr. Heftel, a member of the Subcommittee on Select Revenue Measures, and a very effective member of our committee.

Mr. Heftel.

Mr. Heftel. Mr. Chairman, as we carry on with these deliberations, I think we are going to have to recognize something that is occurring in the nation, namely that the American people no longer tolerate a tax system in which taxpayers with the same income pay different effective tax rates, and we will have to make that a part of our deliberations, if they are going to be meaningful.

Thank you very much.

Chairman Pickle. I thank the gentleman for his comments. Do any other members wish to make preliminary statements?

I am pleased to have you with us this morning, Mr. Heftel. You always make a valuable contribution to our hearings.

We have several panels today, and therefore we are going to ask the participants to summarize and condense their testimony as much as possible. We are not trying to race through these hearings but, due to the number of people testifying, we hope we can make as much progress as possible.

The first panel this morning will consist of Mr. Dallas Salisbury, president of the Employee Benefit Research Institute; Mr. Donald C. Alexander, Esq., on behalf of the U.S. Chamber of Commerce, and Mr. Frank Swain, chief counsel, Office of Advocacy of the U.S. Small Business Administration. Also we have Mr. Michael Romig, director of the Employee Benefits and Human Resources Policy Center with the chamber of commerce.

Our first person will be Mr. Dallas Salisbury, representing the EBRI, a very important and valuable research institution in the United States.

STATEMENT OF DALLAS L. SALISBURY, PRESIDENT, EMPLOYEE BENEFIT RESEARCH INSTITUTE

Mr. SALISBURY. Mr. Chairman, it is a pleasure to be here today for this important discussion of employee benefits. I refer your attention to the package of charts that are in your stack, for my testimony.

In terms of the press release announcing this hearing, a number of specific questions were asked. First, the question of how prevalent are employee and fringe benefit programs, and thus how does this compare to the past. Chart 1 in that package provides information on the prevalence of primary benefits.

Chairman PICKLE. Mr. Salisbury, let me interrupt. We have two different forms. Is this your statement?

Mr. SALISBURY. No, it is underneath that. It is a much smaller package. Mr. Heftel has it.

Chairman PICKLE. You have reference to the charts?

Mr. SALISBURY. Right.

Chairman PICKLE. Are you following your summary?

Mr. SALISBURY. I am following the charts.

Chairman PICKLE. The charts, not the summary?

Mr. SALISBURY. Right.

Chart 1 shows clearly, as was evidenced by Treasury data yesterday, and Health and Human Services data, that primary employee benefits are nearly universal in medium and large employment situations.

As will be shown in detail by the SBA testimony, they are not nearly as universal in small businesses, but for those working in employment settings above 250 employees, we find retirement pensions for 82 percent of those employees, life insurance for 96 percent, health insurance for 96 percent, health insurance for dependents in 93 percent of those situations, long-term stability for 45 percent, and sickness and accident for 49 percent.

How does this compare to the past? One finds that these levels have been fairly consistent for the last 10 years. There has not been significant percentage growth, even though there has been very significant numbers growth, the absolute numbers of millions of Americans protected.

Chart 2 provides a slightly different measurement.

It looks at retirement coverage, future benefit receipt or vesting, if you will, and health insurance coverage for the entire civilian work force as well as what we have dubbed the ERISA work force because it is those over age 25 in full-time jobs. For that smaller population, you find that among all businesses, 70.1 percent of full-time workers have pension coverage, 36.84 percent have a vested right to benefits. That number has been growing significantly, and 83 percent currently have health insurance coverage.

Second, you have asked a question of how much do benefits represent as a percentage of compensation. Chart 3 provides pie diagrams to give you an indication of what we are talking about when we present data on employee benefit programs. You will see that 9.5 percent is required payments, taxable benefits represent 13.9 percent of wages and salaries, tax-favored benefits 9 percent, 4.6 percent of this is health and other fringe benefits, if you will, 4 percent is current contribution to employer retirement programs.

On the right, the percentage of all benefits, you see that the tax-favored benefits represent approximately 27 percent of all benefits currently provided by employes.

Third, you asked the question of how much have tax-favored employee benefit costs grown. Chart 4 presents a schematic diagram, bearing out the information provided by your witnesses yesterday. As the lines indicate, during the high inflation years of the 1970s, the percentage cost of employee benefits grew very dramatically. I think it is interesting to note that preliminary data on 1983 and 1984 shows that these lines have significantly leveled out.

In fact, in terms of what is happening in the future, current surveys indicate that in 1984, employer pension contributions in the private sector are expected to drop by approximately 15 percent, health care inflation from a high in recent years of 17 to 20 percent in premium increases, this year down to 4 and 5 percent.

You have asked the question of how much do benefit costs vary by industry. I think chart 5 is a very interesting graphic presentation of this tremendous cost variation. The tremendous equity issues, if you will, that would arise attempting to put various benefit caps into place, they may well be justifiable policy, but they would be very complex. As you see, for businesses today, expenditures on tax-favored benefits plus Social Security vary from 12.5 percent of wages and salaries to 29 percent of wages and salaries on average for the Fortune 500.

Were one to take this graph and expand it to show the extremes, one would find that some are spending only 6 and 7 percent, others as much as 42 to 43 percent. So, in terms of changing the tax structure, these overriding equity issues would have to be carefully considered.

You also asked which employees by salary range receive employee benefits. Chart 6 attempts to show that in a clear graphic way. One finds that both for coverage and vesting of pension programs, very wide distributions. For those below the poverty level, as was pointed out by the Treasury Department yesterday, coverage is only approximately 32 percent. As one moves to the middle income ranges of $10,000 to $50,000 per year, one finds those numbers climbing to as high as 82 percent, and for those $50,000 and over, 85 percent.

I think, interestingly, the inference of the Treasury witness yesterday was that this implies that pensions principally accrue to the most highly paid. As a result, in order to explore that issue, we provide chart 7.

Chairman PICKLE. Before you go to chart 7, do you have a chart showing the number of people that are not involved in these pensions?

Mr. SALISBURY. You could get this simply by subtracting. In the $50,000 and over it would be 15 percent of the people earning that amount of money are not currently covered by those programs. For $25,000 to $50,000, it would be 18 percent of the civilian work force that would not be covered, and for $10,000 to $49,000 you would be going to 32 percent that were not.

If one looks at the issue, as was discussed yesterday, in terms of equity of the distributions, chart 7 shows that 51 percent of those employed earn between $10,000 and $25,000 per year. They represent 59 percent of those covered by pensions, an overrepresentation for that income group, if you will, and 62 percent of those who are vested in pensions, again an overrepresentation.

If one looks at the highest income categories, they also are overrepresented, with 2 percent of employment, 2.9 percent of coverage, and 4 percent of vesting. But to conclude that the pension system principally provides for the wealthy and the highly paid is clearly not held forth by Census Bureau data and Health and Human Services data, as well as private sector data.

If one looks at health insurance as a benefit, chart 8 presents that information graphically. One finds that health insurance is much more broadly held than pensions, largely because employer surveys indicate that health insurance is generally the first benefit program that any employer chooses to adopt. Those percentages speak for themselves.

Looking at the distributional question, chart 9 shows you that 45.2 percent of all those with health insurance coverage earn between $10,000 and $25,000 per year, 17.1 percent between $25,000 and $50,000 per year. Only 2.8 percent of all those with health insurance earned over $50,000 per year in the last year. I think, again, this indicates the broad distribution of these programs, the fact that any attempt to make a statement that they principally benefit the highly paid and the wealthy is significantly misplaced.

Another question that was asked in the press release was how does employee benefit provision vary by industry. Chart 10 provides that information. As you will see from chart 10, there is significant variation. The lowest coverage levels are found in construction, retail trade, and business and professional services. The highest levels are in the chemical, primary metals, and public employment areas.

For health insurance, it indicates that rates of over 97 pecent are found in primary metals, automobiles, chemicals, communications, while business and personal services firms provide only 59 percent at the low end of that scale. So there is in fact, in terms of yesterday's discussion of what we might describe as horizontal equity, do all firms provide equally, the answer is no.

I think Mr. Swain's testimony will provide some explanations from the viewpoint of Small Business Administration research as to why that may be the case.

You asked what are the economic effects of tax incentives for benefits, and what effects would changes in tax treatment have. Chart 1 presents that information. Yesterday you heard witnesses make statements about levels of tax expenditures, and you had a chart presented to you as table 2 by the Treasury, basically on providing coverage information and implying that these benefits principally, and the tax incentive principally benefited the highly paid.

Chart 11 is taken from a Treasury Department report from the Joint Economic Committee and the Joint Tax Committee in 1982. I think it is very interesting to see what they found in the distribution of taxes paid versus the tax value of benefits. As you see for those under $10,000 per year, in 1981 they paid a toal of 2.6 percent of all taxes paid to the Federal Government, yet received at the minimum 4 percent of the pension tax deferral value, and for nontaxable disability employer-provided programs, a full 83 percent of the tax value.

If one goes to the middle income categories, one finds that in the pension area, between $25,000 and $50,000 per year, all of those middle earners actually get more as a percentage of the tax deferral value than they pay as a percentage of national taxes. It is only as you get to the wealthy that you find that they would actually be better off economically by the Treasury's estimates of the value to them of pension tax deferrals relative to the amount of income taxes that they pay. So I think this is a Treasury study the committee should definitely ask for and look at as a supplement to the testimony provided yesterday.

The tax deferral question, I noticed in the Washington Post this morning the principal thing they noted out of yesterday's hearing was the size, the dollar size of revenue losses to the Treasury. I think chart 12 makes an interesting distinction, the question of revenue lost versus revenue deferred in terms of retirement income programs. If one looks at the pure cash flow methodology and the Treasury itself, former Treasury officials such as Dan Halperin have argued numerous times that a lifetime methodology in this area would be desirable.

As you see, that lifetime methodology indicates that only 14 percent in noninflation adjusted terms, 40 percent in inflation adjusted terms, of the pension tax expenditure is actually ultimately lost to the Treasury.

I will not even argue over the accuracy of the Treasury figure of approximately $50 billion in this year's budget as revenue lost. I think the important point in terms of long-term economic security is what ultimately is lost to the Government in return for retirement income provision. If one takes their estimate of approximately $50 billion for 1983, in that year approximately $87 billion in pension benefits were paid, and those are taxed, so we already have what one might describe as a favorable economic balance.

Chart 13 responds to a question that was asked on the effect of tax changes. I note for reference of the committee, and I think the Department of Health and Human Services should be asked to very carefully look at this particular issue, because many employee benefits are nontaxable today, such as medical benefits, the way in which they are priced for convenience is they are described as a dollar amount per employee. That has been easy, it has been convenient, and in terms of age levels, it has been nondiscriminatory, if you will, because it has not provided a disincentive to hire older workers.

Life insurance, on the other hand, is taxed in excess of $50,000 per year. To accommodate that, the Treasury Department and the

IRS, through Congress' mandate, have created a so-called section 79 table that relates the cost of insurance to an actual tax value. Economic theory and tax theory would suggest that if medical benefits were taxed, they would have to be priced over this same basis, such that for the 55-year-old worker, the taxable value of life insurance would have to be treated as approximately $6,000 per year, whereas the same policy for the worker at age 25 would have a taxable value of only approximately $700 per year.

Chart 13 shows graphically the tremendous increase in the actual outlay cost, because of the amount of benefit paid to an individual that comes about from these programs. In that sense, placing a tax on the premium might well result in the equivalent of deciding that you want to tax benefits as they are received and paid, rather than the premium income. You may well want to do that, but I think this effect is one that you should carefully consider.

It is an effect that, if one looks for consistency in the Tax Code, would almost be required if health insurance taxes were put into effect.

Tenth and finally, you ask what would happen if you put tax caps into effect. Meeting the objective of avoiding any—and I repeat, any, because that is what the press release said—any further tax base erosion from employee benefit and fringe benefit expenditures, which was the question in the press release, I would stress to the committee there is absolutely no way to totally avoid any further tax base erosion, unless you were to follow a course that are to very, very significantly tax benefits already being provided, and almost lower that limit every year as new employers coming into business decided to provide health insurance or other benefits.

I say this not to tell you that you necessarily shouldn't do it, but I think as you look at the numbers and carry it through, if you were, for example, in the health area or in all benefits to say anything above 20 percent of compensation will be subject to FICA taxes, for some employers that would mean as much as 20 percent of current wages and salaries would become subject to FICA tax for some of their employees, on the employer and the employee side. Yet for the hundreds of thousands of businesses that Mr. Swain will speak about, small businesses that do not yet have benefit programs, they would still be able to put in benefit programs and spend up to that 20-percent level.

So a total elimination of tax base erosion, I would suggest, is almost impossible, unless you want to take a step that basically makes all of these things taxable. A policy option, yes, but it needs, I think, to be understood that there is a stark line to be drawn. It can't be done, given that tremendous cost variation shown in one of the charts, easily.

Employer-sponsored programs and social programs, a unique team. Social Security, highly redistributionable, providing significant benefits to those without pension coverage and low-income persons with pension coverage. Supplemental Security Income, to provide for those who fall totally through the cracks. Individual retirement accounts, at least for those without pension coverage, providing an option. Employer-sponsored programs have been shown to provide at least for those with employers of over 250, a nearly universal supplement to retirement income provisions. The system is now maturing. Of new retirees, over 50 percent of married couples are now receiving pension income, over 75 percent will by the turn of the century.

In terms of the dollar-for-dollar value, if one looks at health insurance, the Treasury noted yesterday, a tax expenditure in 1983 was approximately $17 billion. This financed approximately $77 billion in health benefit payments for working Americans. In 1983, employer-sponsored retirement programs represented a tax expenditure of approximately $50 billion. This financed approximately $87 billion in retirement benefits in 1983, and have led to an accumulation of public and private pension reserves of over $1 trillion for the purpose of paying future benefits.

If one looks on the balance of what the government has gotten, what one might be spending from the government from Social Security and Medicare, in the absence of private employee benefits, for working Americans—and I stress for working Americans more than for employers or any other group—for working Americans this has indeed been an effective investment.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF DALLAS L. SALISBURY *, PRESIDENT, EMPLOYEE BENEFIT RESEARCH INSTITUTE

SUMMARY

Retirement, health, life, and disability benefits are widespread, with between 70 percent and 83 percent of full time workers over the age of 25 covered.

Nationally an average of 4.6 percent of wages and salaries is spent on voluntary tax exempt benefits and 4.0 percent on tax-deferred benefits.

These benefits are provided across the salary range, with most going to middle-income households. Over 75 percent of those with coverage earned less than $25,000 in 1982.

Studies by the Treasury and by private economists indicate that benefits enhance tax equity and that taxation of benefits would have the most adverse effect on the lowest earners.

FICA taxes could be lowered if benefits were subject to FICA tax. As the maximum taxable wage base rises, the rate could be decreased as well. Current government estimates overstate the amount, however, because of the assumption that benefits will continue to grow until all compensation is paid as benefits.

Econometric studies indicate that taxation of benefits would lead to reduced availability, but the exact extent cannot be established. Further, it is impossible to assess how much higher direct expenditures might have to be to accommodate these cutbacks.

Imposition of limits or caps that would "prevent further erosion of the tax bases" would (a) mean that no organizations without programs today could establish them or (b) that all employers now with programs would have to pay tax on some portion in order to allow expansion room. Some employers and employees would have to begin paying tax on more than 20 percent of wages and salaries now paid in the form of benefits out of current earnings.

Employer-provided benefits complement social programs, help to maintain public confidence in them, reduce demands placed upon them, and strengthen the economy in the process. Employer retirement plan benefit payments in 1983 exceeded the government calculated tax expenditure by $37 billion and health benefit payments by $60 billion. And costs per covered participant were far below the per participant expense of social programs.

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* The views expressed in this statement are those of Dallas Salisbury and should not be attributed to the Employee Benefit Research Institute, its officers, trustees, sponsors, or other staff.

Employer-provided benefit programs and social programs appear to be an effective partnership. Each provides for particular segments of the population in an effective manner. Each adds to economic security. There are some programs that do not meet this test. During this time of limited resources, they should be reconsidered.

STATEMENT

Mr. Chairman, I am pleased to appear before the Committee today to discuss employee benefits. Following these hearings I would look forward to an opportunity to provide additional assistance to the Committee.

The Committee is to be commended for holding this exploratory hearing into employee benefits and the tax code. The general tax treatment of employee benefit programs has been relatively consistent over time, with health insurance being tax exempt and retirement and capital accumulation programs being tax deferred. The tax treatment of fringe benefits is in transition, with additional "sunsets" ahead. Nearly all current American workers have experienced the present tax treatment of primary benefits for their entire careers. These workers have come to take the presence of social and employer-provided employee benefits for granted: including the current tax treatment of primary employer provided benefits.

Tax laws favoring specific employer retirement and health insurance plans and other statutory employee benefits were enacted under the premise that extensive coverage of workers and their dependents under these plans is desirable social policy. Numerous research studies have documented the fact that these employer based programs complement Social Security and Medicare and reduce long-term demands on these social programs. Further, as I will document, they complement the design of these programs.

The press release announcing this hearing asked a number of specific questions that I will attempt to answer for the Committee. First, how prevalent are employee benefit and fringe benefit programs, and how does this compare to the past?

Chart 1 provides information on prevalence for the primary benefits of retirement, life, health, sickness, and disability for medium and large firms among full-time workers. Health, life, and disability programs are provided to between 90 and 95 percent of these full-time workers and retirement programs to 82 percent. Information is not collected on the fringe benefits (education, legal, van pool) because very small numbers of employees are covered by these programs.

Not all workers are with medium and large firms, however, so we must also look at the total civilian work force. Data collected by the Bureau of the Census in May 1983 for EBRI and the U.S. Department of Health and Human Services provides this information for retirement and health programs.

Chart 2 and Table 1 show that retirement and health programs are prevalent, particularly among those working over 1,000 hours per year. Among full-time employees over the age of 25, 70.01 percent are covered by a pension and 36.84 percent currently are entitled to a vested benefit. Of all civilian workers age 14 to 64, 52.07 percent are covered and 24.35 percent are entitled to a vested benefit. Health insurance is also more readily available to full-time workers, with 83.07 percent having primary coverage compared to 59.66 of all civilian workers.

Retirement program and health insurance coverage have grown significantly in absolute terms, but remained relatively constant in percentage terms over the past ten years.

Second, how much do benefits represent as a percentage of compensation?

According to Chamber of Commerce data, presented in Chart 3 and Table 2, employer contributions to tax-exempt and tax-deferred employee benefits totaled 9.0 percent of wages and salaries in 1982.

Employer contributions to tax-favored benefits—those that are not taxed as current income to the employee—can be divided into two groups: benefits on which taxes are deferred and benefits that are tax exempt.

Tax-deferred benefits include primarily employer contributions to retirement income and capital accumulation plans. These constituted about 4.0 percent of wages and salaries in 1982. Taxation of these benefits is deferred until the employee withdraws funds from the plan.

Tax-exempt include employer contributions to group health insurance and a variety of smaller benefits that include dental insurance, child care, merchandise discounts, and employer-provided meals. These benefits constituted 4.6 percent of wages and salaries in 1982.

Failure to distinguish among the growth of legally required employer payments, fully taxable employee benefits, tax-deferred benefits, and tax-exempt benefits has greatly distorted the perception of the tax-base erosion that can be attributed to tax-favored and tax-exempt benefits.

Third, how much have tax-favored employee benefit costs grown?

Over the past thirty years, tax-favored employee benefits have grown more rapidly than wages and salaries and slightly faster than either legally required employer payments or fully taxable employee benefits. Consequently, tax-favored benefits have absorbed a rising share of total compensation. Chart A and Table 3 show that pension and profit sharing contributions grew significantly in the post ERISA period, and health care cost inflation felt by employer and social programs doubled expenditures for group health insurance. The recent slower growth of employer pension contributions appears to be likely to continue, according to the most recent employer surveys. The slower growth between 1980 and 1982 of employer health insurance contributions as a share to total compensation may reflect the maturation of group health coverage and benefits, as well as employer efforts to contain the cost of private health insurance plans.

"Fringe" benefit expenditures have not increased significantly over this 30 year period. Government data shows that expenditures are less than .5 percent of wages and salaries.

Fourth, how much do costs vary by industry?

The cost of discretionary employee benefits varies significantly from employer to employer, even within industries. Further, there is significant variation among industries. During 1982 total average expense ranged from 12.5 to 29.0 percent of total compensation among Fortune 500 firms. The expenditure would be lower for very young and small businesses. Chart 5 and Table 4 present data for the Fortune 500 for twelve different industry groups. It documents significant variation in expenditures for voluntary tax-exempt and tax-deferred employee benefits.

Fifth, what is expected to happen in the future?

Retirement program and health insurance coverage may well be at a plateau for the near term. For retirement programs, benefits receipt will continue to grow as the system continues to mature, but there are structural questions that need to be explored.

Employee benefit cost rate growth is likely to continue to slow. Employer contributions to retirement programs are expected to decline by 15 percent in 1984 as more plans reach the point of full funding. Health cost inflation is down significantly, which will hold down premium growth. Additionally, employers are moving on many fronts to control health care expenditures today and in the future. Surveys of employers indicate that a changing work force, changing industry structure, and international competition, are combining to put an effective lid on excessive future employee benefit growth.

Employee expenditures on a tax-favored basis, however, are expected to continue to grow. These "salary reduction" features were a part of the Revenue Act of 1978. And contributions to Individual Retirement Accounts (IRAs) are expected to continue to grow also.

Expenditures on all other employee and fringe benefits combined are small, as shown by Chart 3 and Table 2, and these expenditures are not expected to grow significantly.

Sixth, which employees by salary range receive employee benefits?

Primary benefits are broadly distributed across the income spectrum. Charts 6 and 7 and Table 5 show that nearly 83 percent of all nonagricultural wage and salary workers earn less than $25,000 per year. Pension coverage and vesting follow this pattern with 76 percent of those covered earning less than $25,000 and 70 percent of those vested earning less than $25,000. The table also shows that while the proportion of those earning over $50,000 participating in a retirement program is high, these persons represent only 2.89 percent of all pension participants.

Growth of employer group health insurance coverage among workers and their dependents has promoted wide access to health care throughout the population. Health insurance is the most common benefit offered employees in the United States. Charts 8 and 9 and Table 6 show that in 1982 health insurance enjoyed a broad distribution across the income spectrum. Those earning less than $25,000 constituted 80.1 of those with health insurance protection.

Other employee and fringe benefits now, as a matter of law, have to be provided on a non-discriminatory basis. While data is not available, this requirement likely means that distributions are similar.

Seventh, how does employee benefit provision vary by industry?

Retirement program coverage, as shown in Chart 10 and Table 7, varies considerably by industry. The lowest coverage levels are found in construcition, retail trade, and business and professional services. The highest levels are in the chemical, primary metals, and public employment areas.

Chart 10 and Table 7 indicate that health insurance provision is more consistent across industries, but that variation does exist. Rates of over 97 percent are found in primary metals, automobiles, chemicals, and communications, while business and personal services firms provide for 59.92 percent. Health insurance is generally the first benefit employers provide.

Eighth, what are the economic effects of tax incentives for benefits and what effects would changes in tax treatment have?

A number of studies have been done to assess horizontal and vertical equity of the tax provisions. The Treasury Department conducted such a study in 1982. The results of that study are confirmed by a just completed study by economist Sophie Korczyk. Chart 11 and Table 8 show that the tax value of employee benefit incentives parallels tax payments, with low income persons getting more of the value of the tax reductions than their share of tax payments and the highest paid getting less. In other words, a change in the tax treatment of benefits would lead to a regressive result. More recent studies by economists Deborah Chollet and Sophie Korczyk confirmed these findings, as did a CBO analysis of the health care tax cap proposal published in 1983.

Private retirement program tax expenditures form the single largest category of tax expenditures in the federal budget. They arise from the deferral of taxes paid on: (1) pension and retirement saving contributions and (2) earnings on these contributions. The dollar value of the tax expenditure demands that equity and efficiency questions be explored (see Appendix II for a brief discussion of the tax expenditures). A major new study by Sophie Korczyk assesses these incentives in a lifetime context. She finds that the economic value to the government is significantly greater than looking at tax expenditure numbers alone would imply. As much as 72 percent of the real (i.e., inflation-adjusted) value of taxes deferred during the pension participants' working career is ultimately repaid as income tax during retirement.

Chart 12 and Table 9 show that Treasury tax expenditure statistics, calculated on a cash-flow basis, leave the impression that the proportion of current tax deferrals permanently lost to the Treasury is very large. Treasury statistics imply that 83 cents out of every deferred dollar is permanently lost, with the other 17 cents accounted for by current tax payments by retirees. When examined in a lifetime context, the proportion of deferred taxes lost to the Treasury ranges from 14 cents out of every dollar to 40 cents, depending on whether or not one adjusts for inflation and interest on deferred taxes and the interest factor used.

One factor that has not generally been considered is discussing changes in the tax treatment of employee benefits, however, that could involve a significant shift in the incidence of the income tax is the increasing cost, and therefore value of benefits, as workers age. This would represent a major effect of tax policy change.

Employee benefits such as defined-benefit pensions and health insurance are almost always discussed as a flat dollar cost per employee or as a level percentage of pay per employee. Employee representatives, employees, and employers have been content with this approach since the actual distribution of cost does not affect either the taxes to be paid by the employee or the employer. As a result, the only attention given to date to actual per employee cost variation has been undertaken very recently to assess: (1) approaches to health care cost containment and (2) possible disincentives to hiring or keeping on older workers. These recent studies show very significant cost variation by age (Chart 13 and Table 10).

Does this cost variation make a tax policy difference? The answer will be yes if employee benefits were to be subjected to income tax or FICA tax. Employees would come to recognize the inequity involved in paying taxes without reference to the true economic value of the benefit being provided. This could lead to demands for taxing based upon the actual dollar value of the benefit provided or a move to tax the benefits paid instead of the premium. This would require a total restructuring of the way in which benefit programs are run.

Present approaches to health insurance pricing and delivery were developed in the present tax environment. A major change in that environment will have a major affect on those approaches and structures. Nearly all of the government and academic research done on this subject to date assumes that a change in tax policy will not change the method of providing or pricing benefits.

Finally, econometric estimates of private health insurance suggest that significant numbers of persons now covered would not choose to purchase health insurance if it was not available from an employer and largely paid for by the employer.

Tenth, what levels or limits would have to be placed on benefit expenditures to prevent further tax base erosion?

Meeting the objective of avoiding any further tax base erosion from employee benefit and fringe benefit expenditures could be achieved in a number of ways, but none would be simple.

1. FICA

a. Any expenditures beyond those now being made would be subject to FICA tax. This would mean that on average expenditures above 9 percent of wages and salaries would be subject to FICA. But it would also mean that any new plans established would be subject to FICA beginning with the first dollar of expenditure.

b. Any expenditures beyond the current national average would be subject to FICA. Table 4 shows that this would require some employers and employees to begin paying FICA on more than 20 percent of wages and salaries where it is not now paid. To avoid any further erosion, any organization putting in a plan for the first time would pay FICA on every dollar.

c. Any expenditures above 5 percent of wages and salary would be subject to FICA. This would require almost all organizations with benefit programs to pay FICA on some portion of their current expenditures (some on 24 percent of wages and salaries—or more) but would allow room for new organizations to establish programs.

Under present law organizations can spend 15 percent of compensation on retirement programs, and last year the value of the federal civil service pension contribution was over 27 percent. Health, life, and disability add more. This would mean very significant employee tax payments out of current income.

2. INCOME TAX

The same alternatives are available. In the income tax area as well, a goal of "no further erosion"would lead to inequities and to major individual worker and organizational transitions. Table 2 shows the average level above which contributions would have to be taxable, and Table 4 shows how such caps would affect different industries.

Finally, what is the relationship of employer sponsored benefits to social programs?

Social Security, employer-sponsored pensions, and IRAs are complementary, working together to assure retirement incomes. They are not perfect substitutes in terms of benefit delivery, but change in one would effect public pressures for, support for, and confidence in the others.

Social Security provides a floor of protection on a redistributional basis, with lower earners receiving proportionally greater benefits. Many of those who rely most heavily on Social Security do not have high enough incomes to allow savings, and their work is such that they are unlikely to have employer-sponsored retirement plans. Social Security is a pay-as-you-go program. Research indicates that it has no effect, or a negative effect, on aggregate national savings.

Employer-sponsored plans provide another form of "forced" savings that represents a tier of income above Social Security. Among employers with more than 250 employees, these programs are almost universal. Among smaller employers they are not. For a significant portion of the population these advance funded programs represent their only real savings. As a result, research indicates that each dollar contributed to a pension increases aggregate national savings by at least 35 cents.

IRAs are a vehicle for voluntary savings. They are used by 17 million persons as compared to over 50 million with pension coverage. Over 13 million IRA holders also have pension coverage.

There are also differences in what these programs provide, or must provide, under current law. These differences affect the degree to which employer-sponsored plans and IRAs "complement" Social Security in terms of retirement income provision.

Social Security only pays benefits as a stream of monthly benefits.

Employer-sponsored plans are of two types: (1) those that only pay benefits as a stream of monthly benefits—most defined-benefit plans and some defined-contribution plans such as TIAA-CREF and (2) those that make one time "lump-sum" payments at change of employment or at retirement age and thus may or may not produce retirement income—most defined-contribution plans.

IRAs allow the money to be withdrawn at any time with the payment of a small penalty and after age 59 and ½ allow it to be removed as a lump-sum.

Employer-sponsored health programs provide risk protection to most workers and their dependents. Research indicates that taxation of these programs might lead to a reduction in coverage. This in turn could produce significant pressure for a government program to complement present health programs for the poor (Medicaid) and the elderly (Medicare). Employers also increasingly are providing health insurance for retirees to supplement Medicare. Were these programs eliminated it could increase long-term costs of Medicare due to a reduction in wellness.

In 1983 health insurance, according to the Treasury, represented a tax expenditure of approximately $17 billion. This financed approximately $77 billion in benefit payments. In 1983 employer-sponsored retirement programs represented a tax expenditure of approximately $50 billion. This financed approximately $87 billion in retirement benefits paid in 1983. Numerous research studies have been undertaken to assess the degree to which contributions to retirement programs, over $100 billion in 1983, add to national savings. The most pessimistic of these studies concludes that there is a 35 percent addition, or $35 billion in 1983.

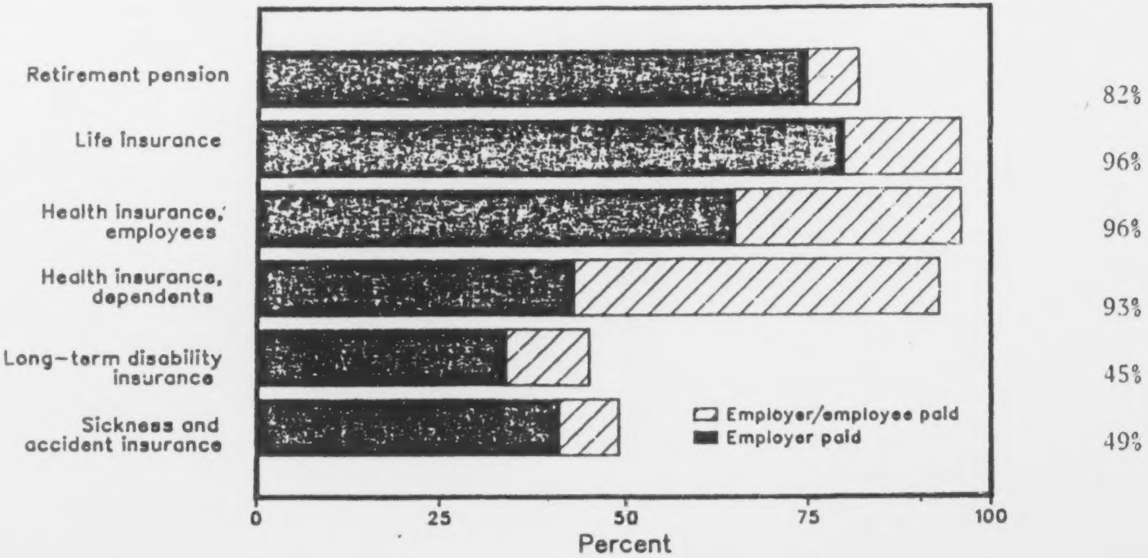
Proposals for tax reform, therefore, need to be carefully scrutinized. To the degree the full taxation of these programs as income rests on the assumption that they will continue to exist, research indicates that for millions of workers they will not. Further, taxation could lead to an unintended age discrimination effect if health insurance were given an income value equal to the benefit provided, which would increase dramatically with age.

CONCLUSION

During a time when there are no apparent limits on direct federal expenditures, or on "tax incentives," analysis may not need to focus on the diversity of employee benefits. During a time of apparent limitations, however, when priorities must be decided upon, careful analysis is required of each employee benefit and why each employee benefit exists. You are to be commended for undertaking this review effort. I would welcome the opportunity to be of additional assistance in the future. Thank you.

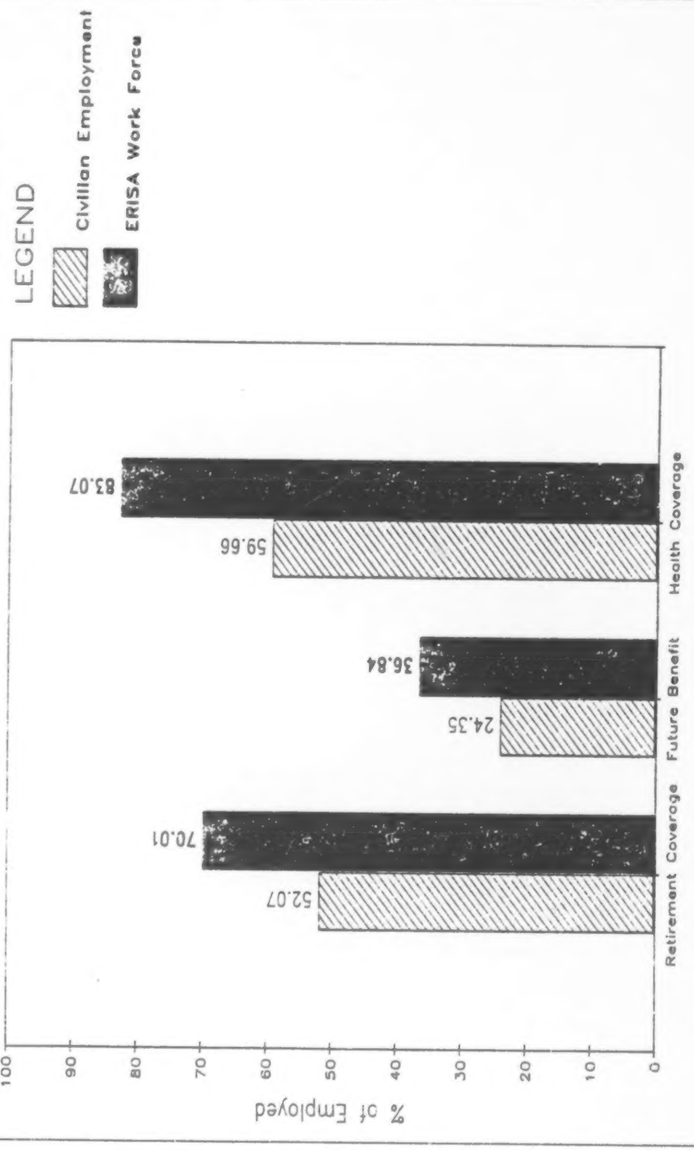
Chart 1

Insurance and pension plans: Percent of full-time employees covered, medium and large firms, 1983



SOURCE: U.S. Department of Labor, Bureau of Labor Statistics, Employee Benefits in Medium and Large Firms, 1983, Bulletin 2213 (Washington, DC: U.S. Government Printing Office, August 1984).

Chart 2
Prevalence of Employee Benefits



Source: Employee Benefit Research Institute

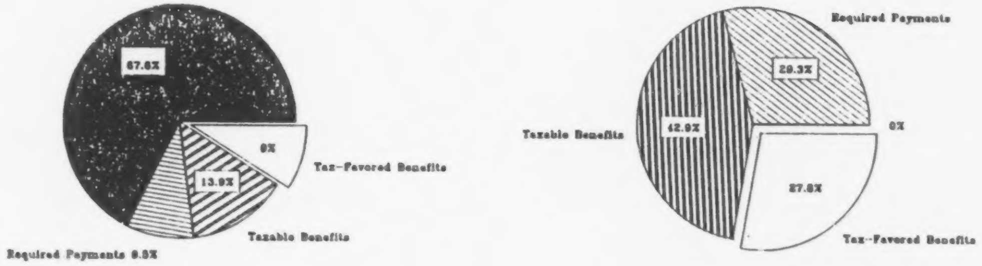
Table 1

Employment, Retirement Program Coverage, Future Benefit Entitlement, and Primary Health Insurance Coverage, May 1983

	Employment	Retirement Coverage	Future Benefit Entitlement	Primary Health Insurance Coverage
		(000's and % of Employed)		
Civilian Employment (All employees & self-employed)	98,964 100.00%	51,530 52.07%	24,095 24.35%	59,041 59.66%
ERISA Work Force (age 25 to 64, working 1000 hours or more, one year of tenure or more)	54,363 100.00%	38,057 70.01%	20,027 36.84%	45,161 83.07%

SOURCE: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement and May 1979 DOL/SSA CPS pension supplement.

Chart 3
Composition of Employee Benefits



Percentage of Wages and Salaries

Percentage of All Benefits

Source: Employee Benefit Research Institute

Table 2

Composition of Employee Benefits by Benefit Group, 1982

Benefit Group	Employer Payments as a Percentage of Wages and Salaries	Employer Payments as a Percentage of All Benefits
Total Benefit Payments	32.5	100.0
Legally Required Employer Payments:	9.5	29.2
Social Security (FICA)	5.2	16.0
Unemployment Compensation	1.1	3.4
Workers' Compensation	0.9	2.8
Other Legally Required Payments a/	2.3	7.1
Discretionary Taxable Benefits:	13.9	42.8
Time not worked b/	9.8.	30.2
Rest Periods	3.8	11.7
Other Taxable Benefits c/	0.3	0.9
Discretionary Tax-Favored Benefits:	9.0	27.7
Contributions to pension and Profit-Sharing Plans d/	4.0	12.3
Group Health, Life, Short-Term Disability Insurance	4.4	13.5
Other Tax-Favored Benefits e/	0.6	1.8
Summary:		
Legally Required Employer Payments and Discretionary Taxable Benefits	23.5	72.0
All Discretionary Benefits	23.0	61.5
Fully Taxable Benefits	13.9	42.8
Tax-Favored Benefits	9.0	27.7

SOURCE: EBRI tabulations of estimates produced by the U.S. Chamber of Commerce, Employee Benefits 1982 (1983), pp. 11 and 28.

a/ Includes government employee retirement, Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, and state sickness benefits insurance.

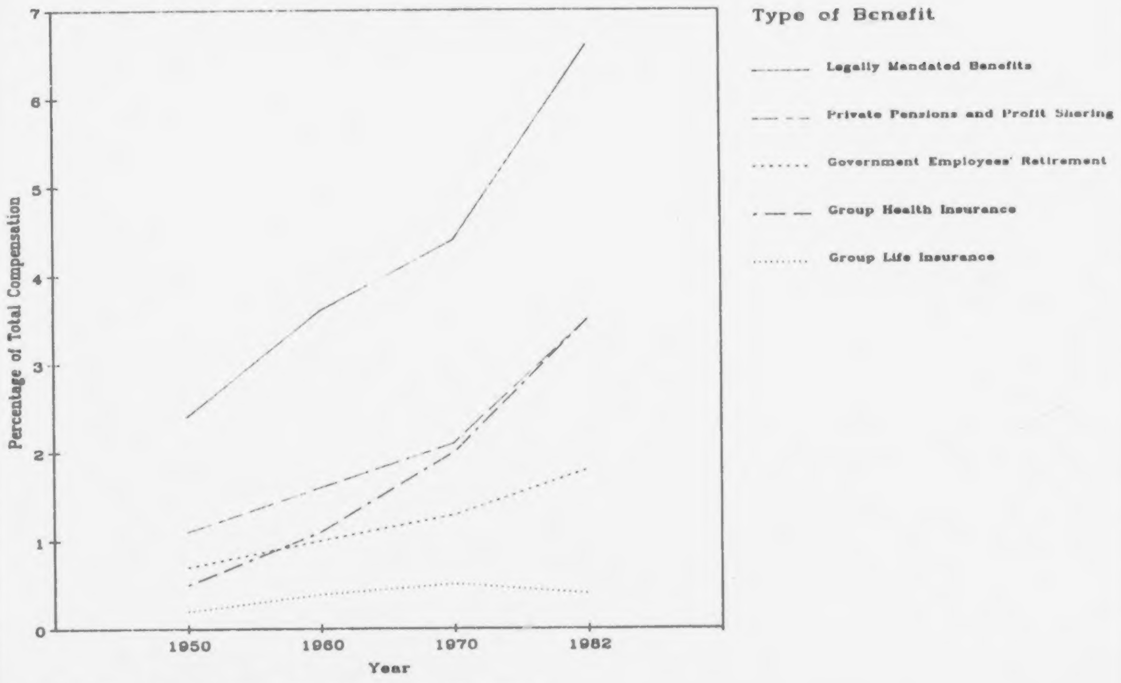
b/ Includes paid vacations and payments in lieu of vacation; payments for holidays not worked; paid sick leave; payments for State or National Guard duty; jury, witness, and voting pay allowances; and payments for time lost because of death in family or other personal reasons.

c/ EBRI estimate based on Chamber of Commerce report of amount of Christmas or other special bonuses, service awards, suggestions awards, special wage payments ordered by courts, and payments to union stewards.

d/ EBRI estimate of Chamber of Commerce report of employer contributions to profit-sharing plans.

e/ EBRI estimate of Chamber of Commerce report of employer-paid dental premiums, merchandise discounts, employee meals furnished by company, payments for vision care and prescription drugs, moving expenses, and contributions to employee thrift plans and employee education expenditures. Tax-preferred benefits are overstated by the amount of separation or termination pay received by employees but not distinguishable from other tax-favored benefits in the Chamber of Commerce estimates.

Chart 4
Employee Benefits Growth
1950 – 1982



Source: Employee Benefit Research Institute

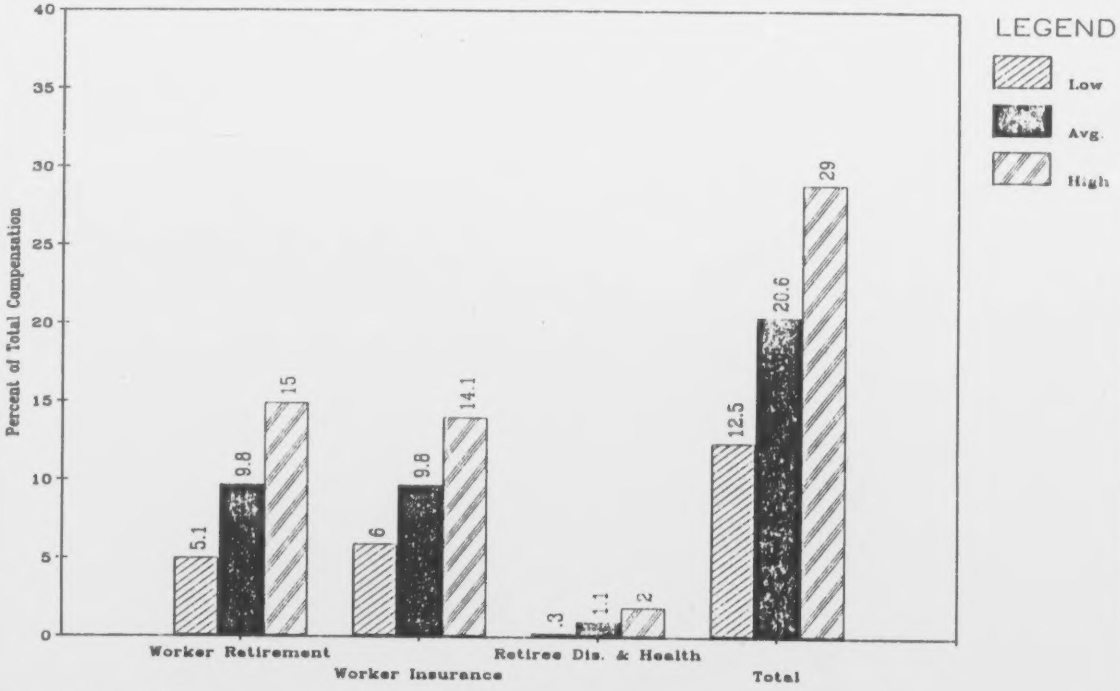
Table 5

Employer Outlays for Employee Benefits in the National Income and Product Accounts for Selected Years, 1950–1982

Type of Benefit	1950		1960		1970		1982	
	Amount (Billions)	Total Compensation (Percent)	Amount (Billions)	Total Compensation (Percent)	Amount (Billions)	Total Compensation (Percent)	Amount (Billions)	Total Compensation (Percent)
Legally mandated benefits								
Social Security Old-Age Survivors and Disability Insurance	$1.3	0.8	$5.6	1.9	$16.2	2.6	$69.2	3.7
Social Security Hospital Insurance	a	a	a	a	2.3	0.4	16.4	0.9
Unemployment Insurance	1.5	1.0	2.8	1.0	3.5	0.6	17.4	0.9
Worker's Compensation	1.0	0.6	1.9	0.7	4.7	0.8	19.9	1.1
Total	$3.8	2.4	$10.3	3.6	$26.7	4.4	$122.9	6.6
Voluntary benefits								
Private pensions and profit-sharing	1.7	1.1	4.9	1.6	13.1	2.1	65.2	3.5
Federal, state, and local government employees' retirement plans	1.1	0.7	2.9	1.0	7.8	1.3	33.8	1.8
Group health insurance	0.7	0.5	3.4	1.1	12.1	2.0	65.7	3.5
Group life insurance	0.3	0.2	1.1	0.4	2.9	0.5	7.2	0.4

SOURCE: Sophie M. Korczyk, *Retirement Security and Tax Policy* (Washington, DC: Employee Benefit Research Institute, (1984).

Chart 5
Employee Benefits Cost Variation



Source: Employee Benefit Research Institute

Table 4

Low, Average and High Employer Contributions to Discretionary Employee Benefits as a Percent of Total Compensation, 1982

Industrial Classifications[1]	Total Worker Retirement[2]			Total Worker Insurance Benefits[3]			Total Retiree Dis. & Health[4]			Grand Total		
	Low	Avg.	High	Low	Avg.	High	Low	Avg.	High	Low	Avg.	High
Petroleum & Refining	8.6	11.2	13.9	6.9	9.0	11.2	.7	.9	1.1	16.2	21.1	26.2
Electronics (Appliances)	6.0	7.6	9.2	7.2	9.0	10.9	.5	.6	.7	13.8	17.2	20.8
Office Equipment (includes computers)	5.1	6.5	7.7	7.6	9.6	11.3	.6	.7	.8	13.3	16.8	19.8
Industrial and Farm Equipment	7.5	9.7	13.6	7.8	10.1	14.1	.7	.9	1.3	15.9	20.7	29.0
Pharmaceuticals	7.4	8.8	9.8	8.1	9.7	10.8	.8	.9	1.0	16.3	19.4	21.5
Chemicals	10.1	11.6	15.0	8.5	9.8	12.6	.8	.9	1.2	19.4	22.3	28.8
Paper, Fiber and Wood Products	7.5	9.2	10.3	8.0	9.9	11.1	.9	1.1	1.2	16.4	20.2	22.6
Food	8.3	10.0	11.6	8.2	9.9	11.5	.7	.9	1.0	17.3	20.8	24.1
Utilities	7.4	10.1	12.6	6.9	9.5	11.9	1.1	1.5	1.9	15.4	21.1	26.4
Life Insurance	8.1	12.5	15.0	6.0	9.1	11.1	1.0	1.6	2.0	15.1	23.2	28.3
Banks	11.4	13.9	15.0	7.2	8.8	10.0	.7	.8	.9	19.3	23.5	26.8
Retailing	6.0	7.1	7.8	6.2	7.4	8.1	.3	.4	.4	12.5	14.9	16.4
Fortune 500	5.1	9.8	15.0	6.0	9.8	14.1	.3	1.1	2.0	12.5	20.6	29.0

Source: EBRI calculations of data provided by Hewitt Associates.

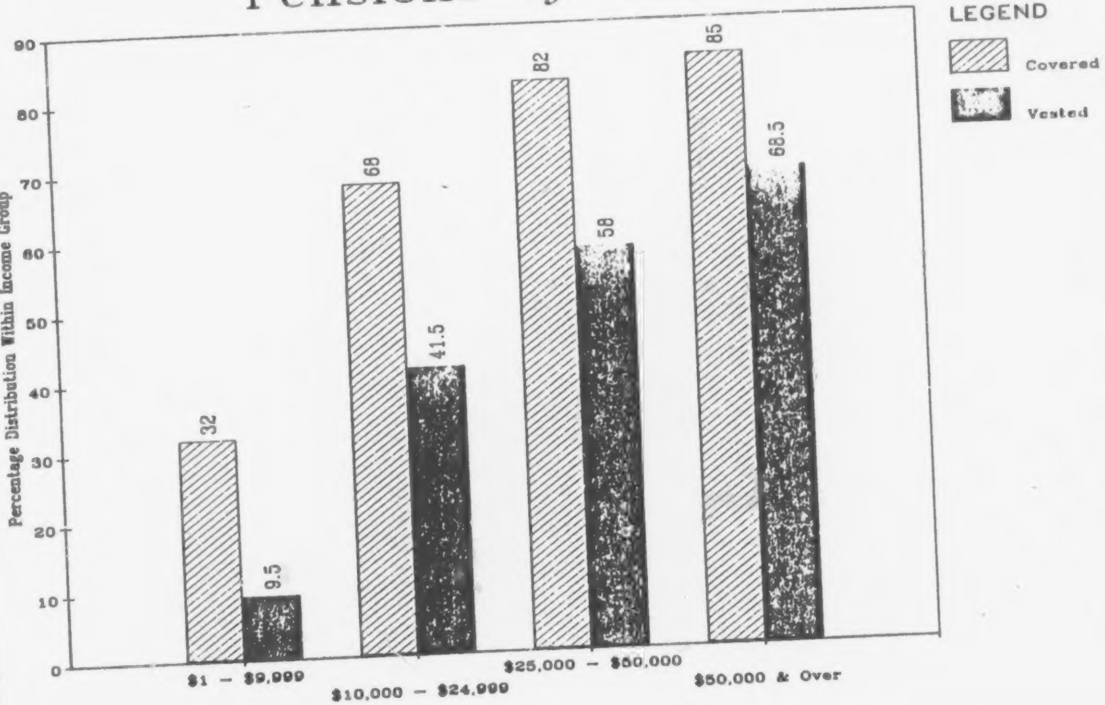
[1] Based on *Fortune* magazine's industrial classifications.

[2] Total worker retirement includes employer contributions to defined benefit and defined contribution pension plans, and profit sharing plans.

[3] Total worker insurance benefits includes employer outlays to group life and survivor plans, long- and short-term disability plans, and health insurance (including medical, dental and vision plans).

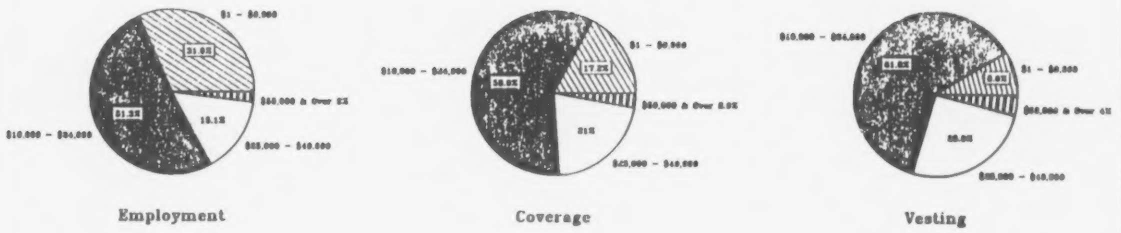
[4] Total retiree disability and health includes employer contributions to health insurance and disability income for retirees.

Chart 6
Pensions by Earnings



Source: Employee Benefit Research Institute

Chart 7
Pensions by Earnings
Percentage Distribution Across Income Groups



Source: Employee Benefit Research Institute

Table 5

Employment Coverage and Vesting:
Distribution by Earnings for
Nonagricultural Wage and Salary Workers, May 1983

	Number of Workers (000's)*		
Earnings	Employment	Coverage	Total Vested Benefits
Total	80,289	47,372	27,603
$1-4,999	10,014	2,433	358
$5,000-9,999	15,323	5,747	2,023
$10,000-14,999	17,827	10,328	5,484
$15,000-19,999	13,101	9,422	5,874
$20,000-24,999	10,283	8,159	5,641
$25,000-29,999	5,515	4,365	3,048
$30,000-50,000	6,611	5,547	4,072
$50,000 and over	1,615	1,371	1,106

	Percentage Distribution Within Income Group		
	Employment	% Covered to Employed	% Vested to Employed
Total	100.00%	59.00%	34.38%
$1-4,999	100.00	24.29	3.57
$5,000-9,999	100.00	37.51	13.20
$10,000-14,999	100.00	57.93	30.76
$15,000-19,999	100.00	71.92	44.83
$20,000-24,999	100.00	79.34	54.85
$25,000-29,999	100.00	79.14	55.26
$30,000-50,000	100.00	83.91	61.57
$50,000 and over	100.00	84.90	68.50

	Percentage Distribution Across Income Groups		
	% Employment	% of Coverage	% of Total Vesting
Total	100.00%	100.00%	100.00%
$1-4,999	12.47	5.14	1.30
$5,000-9,999	19.08	12.13	7.33
$10,000-14,999	22.20	21.80	19.87
$15,000-19,999	16.32	19.89	21.83
$20,000-24,999	12.81	17.22	20.43
$25,000-29,999	6.87	9.21	11.04
$30,000-50,000	8.23	11.71	14.75
$50,000 and over	2.01	2.89	4.01

*Excludes workers without reported earnings

SOURCE: Employee Benefit Research Institute tabulations of May 1983 EBRI/HHS CPS pension supplement.

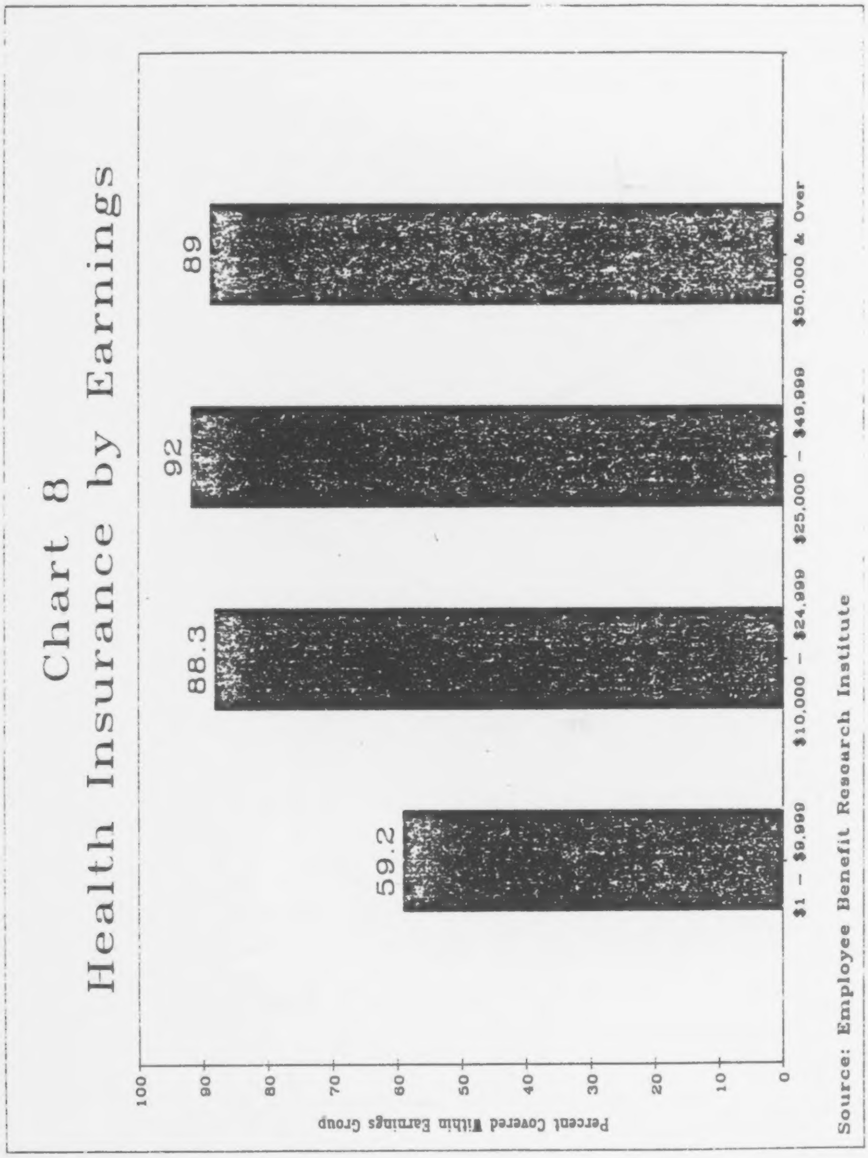


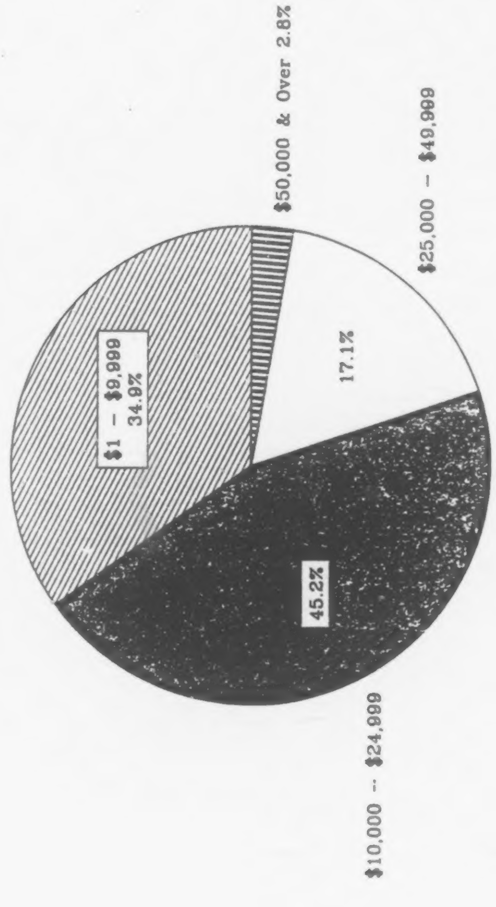
Chart 8
Health Insurance by Earnings

Source: Employee Benefit Research Institute

Chart 9

Health Insurance by Earnings

Percent of All Workers with Coverage



Source: Employee Benefit Research Institute

Table 6

Distribution of Workers
Covered by an Employer Group Health
Insurance Plan by Personal Earnings, 1982 a/

Personal Earnings	Workers with Employer Coverage b/ (in millions)	Percent of Workers within Earnings Group	Percent of All Workers with Employer Coverage
Loss	1.1	41.2	0.5
$ 1-$ 4,999	29.5	53.3	18.4
5,000- 7,499	10.8	64.6	8.1
7,500- 9,999	9.1	74.1	7.9
10,000- 14,999	19.0	84.7	18.8
15,000- 19,999	14.3	90.0	15.1
20,000- 24,999	10.5	92.5	11.3
25,000- 29,999	6.8	93.6	7.5
30,000- 34,999	4.2	93.0	4.6
35,000- 39,999	2.3	93.0	2.5
40,000- 49,999	2.3	90.8	2.5
50,000- 59,999	1.1	91.1	1.2
60,000- 74,999	0.7	88.3	0.7
75,000 or more	0.9	86.2	0.9
Total, All Workers c/	112.7	75.9	100.0
Summary:			
Loss-$ 9,999	50.5	59.2	34.9
$10,000- 24,999	43.8	88.3	45.2
25,000- 39,999	13.4	93.3	14.6
40,000 or more	5.1	89.7	5.3

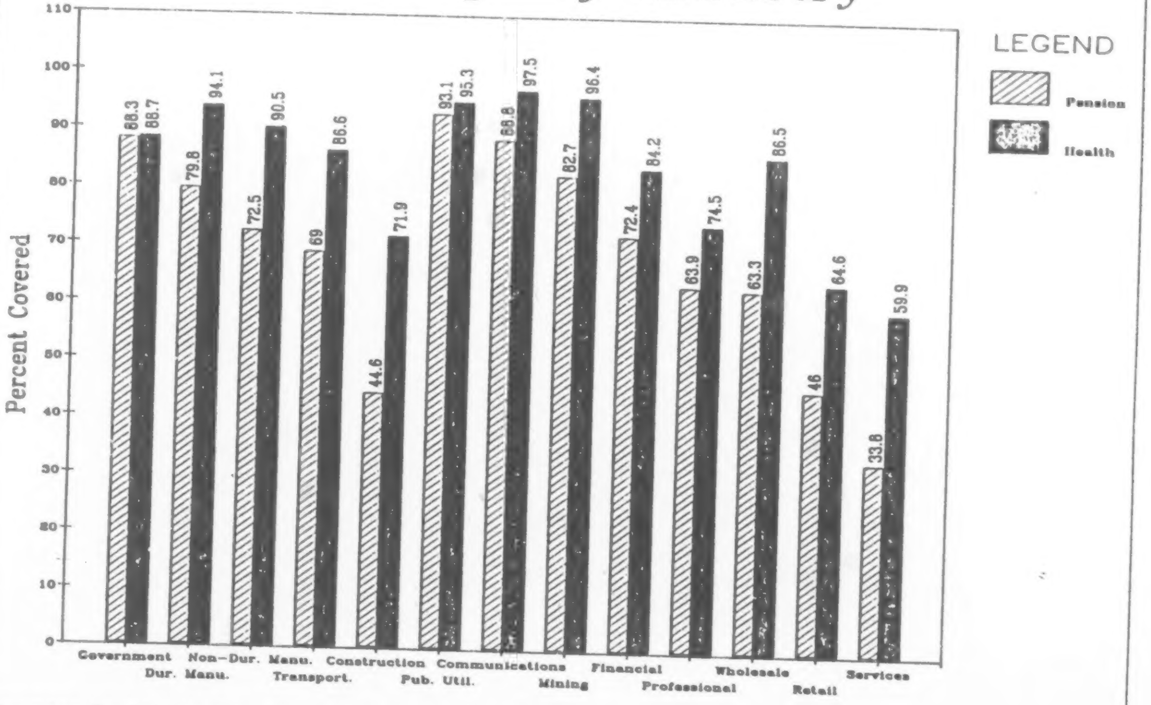
SOURCE: Employee Benefit Research Institute tabulations of the March 1983 Current Population Survey (U.S. Department of Commerce, Bureau of the Census).

a/ Includes all nonagricultural civilian workers who reported employer group health insurance coverage at any time during 1982, except workers in families in which the greatest earner is a member of the Armed Forces or an agricultural worker.

b/ Includes coverage from the worker's own employer group plan or from the plan of another worker.

c/ Items may not add to totals because of rounding.

Chart 10
Coverage by Industry



Source: Employee Benefit Research Institute

Table 7

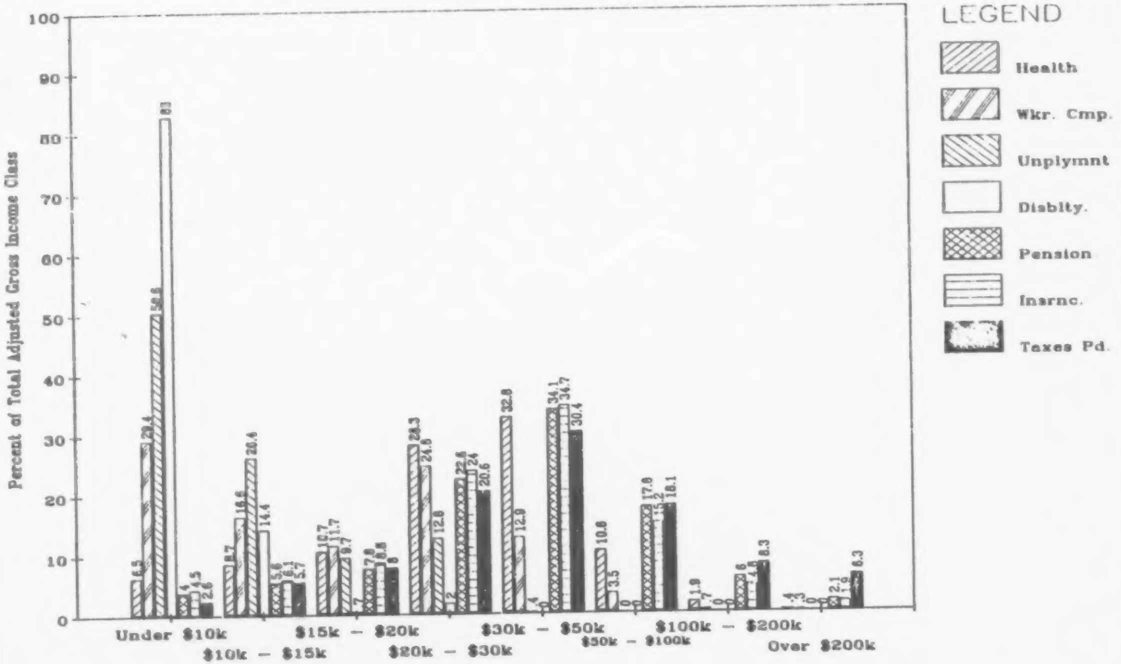
Employment and Coverage in the
ERISA Work Force by Industry, May 1983

INDUSTRY	Employment (000's)	Percent Covered	
		Pension	Health
GOVERNMENT	11,905	88.26%	88.73%
DURABLE MANU.	8,492	79.84	94.17
Primary Metals	702	89.81	97.70
Automobiles	823	92.56	98.41
NONDURABLE MANU.	5,862	72.56	90.52
Apparel	697	45.82	75.55
Chemicals	970	91.89	97.38
TRANSPORTATION (ex-railroads)	1,454	68.98	86.56
CONSTRUCTION	2,130	44.56	71.93
PUBLIC UTILITIES	811	93.11	95.30
COMMUNICATIONS	1,200	88.75	97.46
MINING	660	92.72	96.43
FINANCE, INSURANCE & REAL ESTATE	3,444	72.42	84.20
PROFESSIONAL SERVICES	6,401	63.95	74.48
WHOLESALE TRADE	2,682	63.26	86.50
RETAIL TRADE	5,833	45.96	64.56
BUSINESS & PERSONAL SERVICES	3,184	33.83	59.92

SOURCE: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement and May 1979 DOL/SSA CPS pension supplement.

[a] Number of workers too small to be statistically significant.

Chart 11
Benefits
Revenue Loss and Taxes Paid



Source: Employee Benefit Research Institute

Table 8

Revenue Loss for Major Benefits and Taxes Paid by Income Class as Percent of Total Adjusted Gross Income Class, 1981[a]

Adjusted Gross Income Class	Exclusion of Employer Contributions for Medical Insurance & Medical Care	Exclusion of Worker's Compensation Benefits	Exclusion of Untaxed Unemployment Insurance Benefits	Exclusion of Disability Pay	Net Exclusion of Pension Contributions & Earnings[b]	Exclusion of Insurance Premiums[c]	Percent of Total Taxes Paid
Less than $10,000	6.5%	29.4%	50.6%	83.0%	4.0%	4.5%	2.6%
$ 10,000 to $ 15,000	6.7	16.6	26.4	14.4	5.6	6.1	5.7
$ 15,000 to $ 20,000	10.7	11.7	9.7	0.7	7.8	8.8	8.0
$ 20,000 to $ 30,000	28.3	24.8	12.8	2.0	22.6	24.0	20.6
$ 30,000 to $ 50,000	32.8	12.9	0.4	-	34.1	34.7	30.4
$ 50,000 to $100,000	10.6	3.5	-	-	17.8	15.2	18.1
$100,000 to $200,000	1.9	0.7	-	-	6.0	4.8	8.3
$200,000 and over	0.4	0.3	-	-	2.1	1.9	6.3

SOURCE: EBRI calculations based on U.S. Congress, Congressional Budget Office, Revising the Individual Income Tax, July 1983 (Washington, D.C.: U.S. Government Printing Office, 1983), Table 9, pp. 62 and 63.

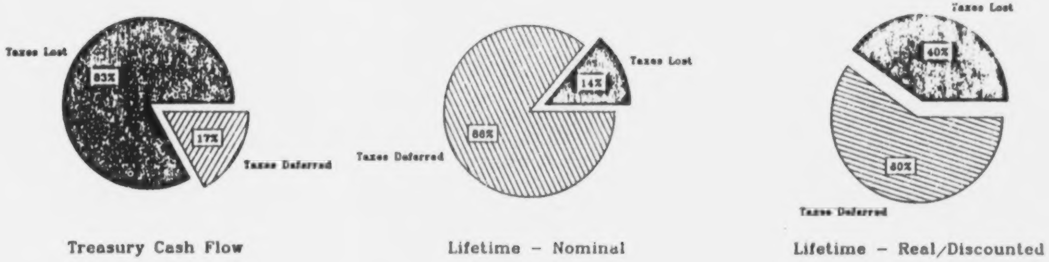
NOTE: Percents may not add to 100.0 percent due to rounding.

[a] 1981 income levels and 1982 law.

[b] Includes the exclusion of contributions and earnings for employer plans and plans for the self employed and others.

[c] Includes premiums for group-term life insurance and accident and disability insurance.

Chart 12
Pensions
Revenue Lost Vs. Deferral



Source: Employee Benefit Research Institute

Table 9

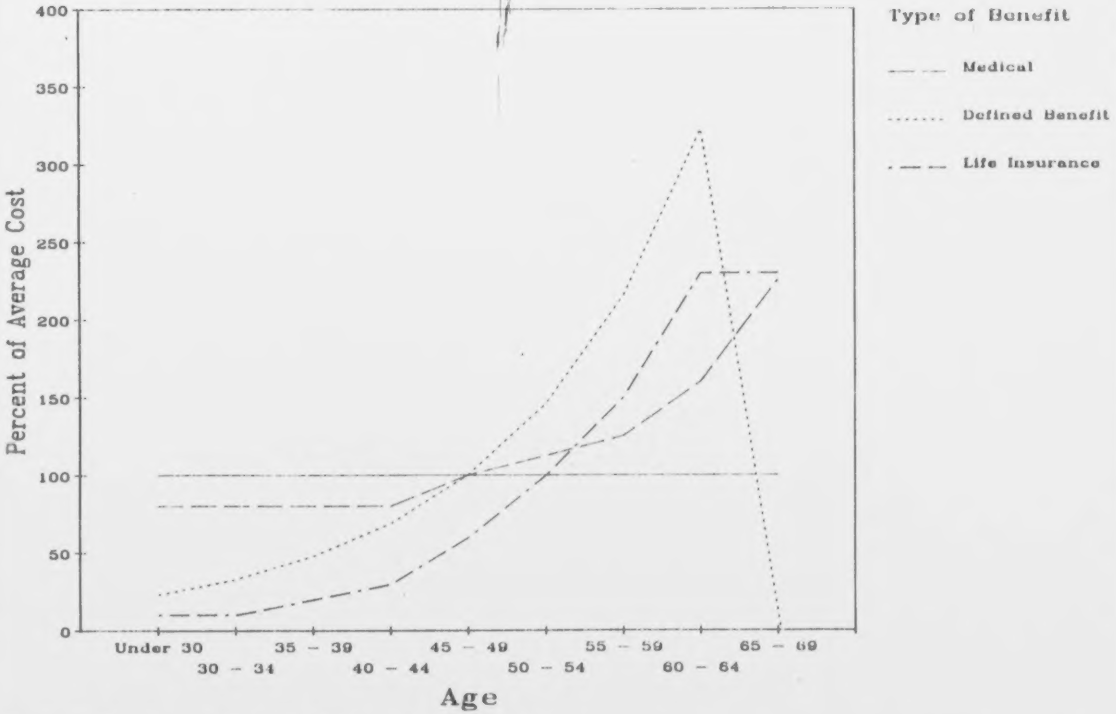
How Much of Pension-Related Tax Deferrals is Lost to the Treasury?

Method Used	Taxes Lost	Taxes Deferred
Treasury Method	83%	17%
Lifetime Method:		
Nominal dollars a/	14	86
Real dollars b/	28	72
Discounted for interest: c/		
at pension rate	40	60
at federal rate	36	64

SOURCE: Sophie M. Korczyk, Retirement Security and Tax Policy (Washington, DC: Employee Benefit Research Institute, 1984).

a/ Before adjusting for inflation.
b/ After adjusting for inflation.
c/ Interest rate used to discount taxes paid in retirement to the year of retirement.

Chart 13
Benefit Cost by Age



Source: Employee Benefit Research Institute

Table 10

Summary of Cost Factors by Age for Use in Costing Benefit Plans

Age Group	Medical Cost Factor as % of Average Cost	Defined Benefit Cost Factor as % of Average Cost	Life Insurance Cost as % of Pay for One Times Pay
Under 30	80.0%	23.0%	0.1%
30-34	80.0%	33.0%	0.1%
35-39	80.0%	48.0%	0.2%
40-44	80.0%	69.0%	0.3%
45-49	100.0%	100.0%	0.6%
50-54	112.5%	146.0%	1.0%
55-59	125.0%	216.0%	1.5%
60-64	160.0%	323.0%	2.3%
65-69	225.0%	*	2.3%

SOURCE: *The Costs of Employing Older Workers* (Washington, DC: U.S. Special Committee on Aging and the Employee Benefit Research Institute, forthcoming).

Note: Same life insurance cost is assumed for 65-69 as for 60-64 because it is assumed that the benefits will be reduced to equal cost; regulations allow a 30% reduction.

If benefits are not reduced, assume costs at 65-69 are about 30% higher.

Defined contribution costs are the same by age.

ENDNOTES

Should you wish to review the primary economy research on which this statement is based the following are suggested.

For background on flexible benefits plans and their relevance to changing employee needs, see Dallas L. Salisbury, ed., America in Transition: Implications for Employee Benefits (Washington, DC: Employee Benefit Research Institute, 1982); EBRI Issue Brief, "Flexible Compensation and Public Policy," No. 24 (Washington, DC: Employee Benefit Research Institute, November 1983); and Chapter XXII, "Flexible Compensation Plans" in Fundamentals of Employee Benefit Programs (Washington, DC: Employee Benefit Research Institute, 1983).

For further analysis of the tax treatment issues, see Sophie M. Korczyk, Retirement Security and Tax Policy (Washington, DC: Employee Benefit Research Institute, 1984). See also EBRI Issue Brief "Pension-Related Tax Benefits," No. 25 (Washington, DC: Employee Benefit Research Institute, December 1983); and EBRI Issue Brief "Employee Benefit Research Institute, February 1984).

For discussion of the interrelationship of programs see Sylvester J. Schieber, Social Security: Perspectives on Preserving the System (Washington, DC: Employee Benefit Research Institute, 1982).

Alternative tax systems would require detailed judgments about the treatment of various sources and uses of income. Both would also create some formidable implementation and transition problems. These problems and issues are treated in detail elsewhere. For a discussion of employer pensions in basic tax reform, see Sophie M. Korczyk, Retirement Security and Tax Policy (Washington, DC: Employee Benefit Research Institute, 1984) and EBRI Issue Brief, "Basic Tax Reform: Implications for Employee Benefits," No. 28 (Washington, DC: Employee Benefit Research Institute, March 1984. For a wide-ranging discussion of theoretical and practical issues in basic tax reform, see Dallas L. Salisbury, ed., Why Tax Employee Benefits? (Washington, DC: Employee Benefit Research Institute, 1984).

In smaller plans, the cost of providing health insurance for the marginal employee is based on the average costs of insuring the insured population of that community. In larger plans, the cost of insuring the marginal employee is based on the average cost of insuring the population represented by that employer's work force. While these two methods would be likely to yield different insurance costs for any given employee, under either method the cost of insuring that employee does not represent the cost of that employee's expected claims.

For a thorough discussion of health insurance see Deborah J. Chollet, Employer-Provided Health Benefits: Coverage, Provisions, and Policy Issues (Washington, DC: Employee Benefit Research Institute, 1984), p. 94. An EBRI simulation of private health insurance suggests that 56 to 87 percent of all covered workers with 1979 family income less than $15,000 would not have purchased private health insurance if an employer had not offered and contributed to their health insurance plan.

APPENDIX I

WHAT ARE EMPLOYEE BENEFITS?

Employee benefits represent virtually any form of compensation that is provided in a form other than direct wages, paid for in whole or in part by the employer, even if provided by a third party. Generally, media articles, cost surveys, and reports lump all benefits together. But different benefits serve different social and economic needs. For legislative policy assessment purposes, benefits can be classified into at least nine categories:

1. Legally required benefits (including employers contributions to Social Security, Medicare, unemployment insurance, and workers' compensation insurance);
2. Discretionary benefits that are fully taxable (primarily, payment for time not worked);
3. Discretionary benefits that insure the employee against financial risks and are tax exempt (including employer contributions to health, life, and disability insurance plans);
4. Discretionary benefits that help the employee meet special needs and are tax exempt (including employer contributions to child care and legal plans);
5. Discretionary benefits that have traditionally been called fringes and are intended to meet employer needs and are tax exempt (including employer provision of purchase discounts, job site cafeterias, special bonuses and awards, van pools, clubs, and parking);
6. Discretionary "reimbursement account" benefit programs that have been legally allowed since 1978 which allow employees to have reimbursement accounts—

funded by the employer or through salary reduction—to pay expenses that fall into "statutory benefit" areas and are tax exempt (including health care reimbursement, child care reimbursement, etc.);

7. Discretionary benefits that provide retirement income as a stream of payments and for which taxes are deferred until benefits are received (including employer contributions to defined benefit pension plans and to defined contribution plans which require payment in the form of an annuity);

8. Discretionary benefits that provide for the deferral of salary until termination of employment, generally pay benefits as a lump sum, and for which taxes are deferred until benefits are received (including contributions to some profit sharing plans, to money purchase plans and ESOPs); and

9. Discretionary benefits that provide for the deferral of salary until special needs arise (loans and hardship), or until termination of employment, generally pay benefits as a lump sum, and for which taxes are deferred until benefits are received (including contributions to some profit sharing plans, thrift-savings plans, and salary reduction plans).

Appendix II

A Comment on the Controversey Over Tax Expenditure Estimates for Pension Plans

(By Dallas L. Salisbury*)

The United States Treasury makes annual estimates of tax expenditures in response to mandate of the Congressional Budget Act of 1974. These estimates are published each year in the President's Budget along with many cautionary notes on how they can legitimately be used.

A reading of academic, public, and other publications leads one to the irrefutable conclusion that these cautions are frequently unneeded. For example, some use them to indicate the revenue that would be gained by the government if the law were changed. The Budget points out that this is not a proper use of the numbers because, among other reasons, they are calculated as if no other tax provisions existed and as if human behavior would in no way be affected by eliminating the tax preference.

The Employee Benefit Research Institute (EBRI) is concerned with economic security and with doing what it can to assure that policy makers have appropriate information available to them as they assess policy choices. Early in 1983, EBRI received press inquiries regarding the tax expenditure numbers in the FY 84 Budget. As a result of those discussions, the then EBRI research director and economist Sylvester J. Schieber wrote and published EBRI Issue Brief Number 17 (April 1983) on the subject of "Retirement Program Tax Expenditures."

Alicia H. Munnell suggests in her note on this subject that the Issue Brief "initiated the debate over the accuracy of the estimates." The literature indicates that this debate has been ongoing, but I will agree that the Issue Brief was an addition to the debate. Munnell then mentioned that "a primary concern of EBRI was that the figures published by the Treasury jumped dramatically and apparently without explanation from year to year."

The Issue Brief raised other concerns as well:

Budget deficits might cause pension policy to be made based upon considerations of perceived cost without sufficient consideration of benefits provided.

Tax expenditure estimates could be used inappropriately as indicators of revenue that could be gained by changes in the tax treatment of pensions without reference to the limitations inherent in the numbers which are outlined in the budget.

Dramatic increases in the numbers which were unexplained might inappropriately be attributed to a changed pension system rather than inclusion of public pensions for the first time.

The Issue Brief then explored the question of whether or not the figures, as presently published by the Treasury, accurately reflect the revenue loss associated with the favorable tax treatment of pensions. Munnell's note failed to deal with the most important factor in making this determination: the partial equilibrium nature of the Treasury calculations. Partial equilibrium means that real world behavior is assumed away. That is, if the law is changed, everyone is assumed to still behave in exactly the same way. If the IRA tax preference were removed, people would still put their money in IRA's. The budget goes to great lengths to warn against using the tax expenditure numbers to assess how much revenue could be gained if a particular tax incentive were removed. In other words, no partial equilibrium number is "accurate."

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* President, Employee Benefit Research Institute. The views expressed herein are the authors and should not be attributed to EBRI.

Munnell then says that "two arguments could be made that the calculated figures exaggerate the impact of employer-sponsored pension plans on tax revenues." She is correct that pension fund earnings may be overstated. She is also correct that contributions overstate the cost of current benefits. She ignores other reasons however. For example:

Other tax code provisions such as the elderly double exemption bring marginal rates down. This reduces pension repayment and increases what is called the pension tax expenditure. But this increase is due to the other provision.

The cross section approach used in the budget offsets this year's contributions and earnings against benefits paid this year. These numbers relate to different groups of people and fail to account for the age of the pension system or the fact that this relationship will change in the future. This overstates the tax expenditure today and will understate it thirty years from now.

The current method of calculation counts as pension tax expenditures amounts that would not be taxed in the absence of pensions due to other provisions of the code such as capital gains tax deferrals, municipal bonds, the elderly real estate gain exclusion, etc.

Munnell then quickly notes: "On the other hand, the revenue loss for public plans is almost certainly underestimated since these funds are not fully funded and hence contributions are less than accruing benefits." Whether under Social Security, civil service retirement, military retirement or private pensions, the concept that the tax expenditure should be calculated on the benefit accrual rather than contributions is revolutionary. Under such a new approach the Social Security and Medicare tax expenditures would dwarf those for pensions, and employees would be "charged with income" that they might never see due to the benefits being unfunded. Munnell's new approach cannot be justified. Yet, it is the only reason she provides for stating that the tax expenditures are understated.

Therefore, Munnell's conclusion that "In view of the offsetting errors, then, the Treasury's current estimates of the tax expenditure for pension plans probably provide a reasonable approximation of the revenue loss" cannot be supported. And Munnell certainly does not document it in her note.

Munnell then states: "Essentially, the calculation is designed to meausre how much higher federal revenues would be in a given year if a particular subsidy had not been enacted." This statement directly contradicts the budget of the United States. The budget specifically warns against using the number for this purpose because of its partial equilibrium limitations. The number could only be used in this way if the preference being evaluated were the only tax preference item available.

Munnell then agrees with the Issue Brief in noting that a lifetime basis should be used to calculate the pension tax expenditure. Munnell then undertakes a partial equilibrium present value exercise that approximates a lifetime estimate. She produces a high number and concludes: "Thus, the revenue loss associated with the favorable treatment of pension contributions and earnings is substantial regardless of how it is measured."

Again, Munnell cannot support her numbers or her conclusion. By using the current level of contributions, investment earnings and benefit payments, Munnell assumes that the system will never change. Demographic changes in the future will guarantee that this assumption is wrong. Further, Munnell's new calculation is still partial equilibrium and has all the weaknesses that the budget attributes to the Treasury numbers.

Munnell concludes her note with the comment that: "The debate over the precise magnitude of the tax expenditure is an unproductive digression that diverts attention from the important topic of whether the favorable tax treatment accorded contributions to private pension plans represents an efficient and equitable use of scarce federal resources."

The problem is that one can only assess whether benefits are sufficient to justify the cost, if one knows the cost. The tax favored pension plans will, according to government estimates, pay $87.5 billion in benefits to retirees in 1985. What should this be measured against? $28 billion; $50 billion; $62 billion? Do all these numbers indicate that at this point the government gets more than it gives?

Munnell never mentions anything but the tax expenditure. Her articles don't provide the information that would allow one to pursue the "important topic." Munnell is prepared to use the tax expenditure number in a way that the budget says it cannot be used; EBRI is not. EBRI attempts to provide information to allow persons to assess both the cost and the benefit issue; Munnell does not. Munnell advocates particular policy courses; EBRI does not.

EBRI subscribes to the American notion that there is a role to be played by the public sector, the private sector, and the individual in meeting economic security needs; Munnell's written work indicates that she believes it could best be done by Social Security. Munnell distributes critiques of the work of others without first discussing the work being critiqued with the author—as the Munnell note evidences; EBRI does not.

A debate over any established public policy is justified and further, should take place from time to time to assure that a national consensus still exists. Such debate, when it involves the pension benefits of over 16 million current retirees and over 50 million current workers, must be based upon an accurate assessment of costs and benefits—as should all debates. No time spent attempting to get to accurate numbers can legitimately be labeled "an unproductive digression." Those who feel that a call for facts is "an unproductive digression" cannot be viewed as objective analysts. Thus, Munnell should be seen as an advocate for the policy positions she has articulated in her written work. Munnell has already reached her conclusions without aid of accurate estimates of the cost of the pension tax incentives and without the facts on the benefits the system provides. EBRI is doing over $1 million in research each year to get the facts. Whatever they are, they are broadly distributed. They will, in time, provide the basis for informed decisions on whether tax incentives for pensions are efficient and effective. They have already provided a basis for more complete understanding than was possible when Munnell reached her conclusions in 1981.

EMPLOYEE BENEFITS—RETIREMENT AND HEALTH—BY STATE

Reports have been issued in the past assessing pension and health insurance coverage for the nation. The tables that follow break down the 98.9 million civilian workers by state for two populations:

Tables 1 and 2 present the information for all civilian workers. The tables indicate significant state by state variation in coverage levels. Nationally pension coverage is 52 percent; varying from 37 percent in Arkansas to 62 percent in Delaware for all workers. Health coverage nationally is 59 percent; varying from 37 percent in Montana to 66 percent in Delaware.

Tables 3 and 4 present the information for the "ERISA work force": those over age twenty-five with at least one year on the job and working more than 1,000 hours during the year. Among these full-time, full-year workers, pension coverage is 70 percent nationally; varying from 53 percent in Florida to 82 percent in Delaware. Health coverage was 83 percent nationally; varying from 72 percent in North Dakota to 89 percent in North Carolina.

This second population is more useful for analysis since these are work related benefits. The total civilian work force, for example, includes all persons over age fourteen who work at all for pay during the year.

The tables also provide average income figures for all workers and for those with pension and health protection.

For the total civilian work force, average income is 22 percent below that of those with benefit protection. The total civilian work force has average income 21 percent below the older ERISA work force. Those with pension and health coverage earn 9.2 percent more, on average, than the total ERISA work force.

TABLE 1.—1983 EBRI/HHS CURRENT POPULATION SURVEY MAY PENSION SUPPLEMENT EMPLOYEE BENEFIT UTILIZATION

State	Civilian work force	Average income	Pension coverage	Percent covered	Average income
Total	98,963,821	$15,961.27	51,531,197	52.17	$19,499.17
Alabama	1,412,881	14,614.37	674,932	47.77	17,984.26
Alaska	169,352	23,868.26	81,745	48.27	26,994.26
Arizona	1,220,314	16,141.70	594,602	48.73	19,706.17
Arkansas	892,638	11,562.23	330,421	37.02	14,386.59
California	10,552,286	18,168.23	5,408,747	51.26	21,965.81
Colorado	1,461,703	17,061.65	714,540	48.88	21,705.48
Connecticut	1,514,791	18,858.37	881,211	58.17	22,258.68
Delaware	277,260	16,710.21	173,691	62.65	19,541.73
District of Columbia	262,714	17,310.46	136,984	52.14	19,247.80
Florida	4,506,621	13,487.39	1,793,325	39.79	16,031.38
Georgia	2,432,688	13,829.38	1,176,805	48.37	17,193.57
Hawaii	470,799	16,031.15	257,399	54.67	19,334.15
Idaho	366,862	15,263.51	184,927	50.41	19,431.39
Illinois	4,867,743	17,600.74	2,706,505	55.68	21,340.21
Indiana	2,304,353	14,765.10	1,266,161	54.95	17,871.58
Iowa	1,228,463	14,381.88	644,368	52.45	16,929.30
Kansas	1,049,375	14,713.55	507,713	48.38	17,910.71
Kentucky	1,345,239	13,924.41	708,125	52.64	17,178.53
Louisiana	1,528,105	14,754.59	673,063	44.05	18,454.00
Maine	530,634	13,192.55	251,164	47.33	16,221.57
Maryland	2,009,861	18,461.43	1,211,853	68.30	21,824.03
Massachusetts	2,653,158	16,368.66	1,489,831	56.15	18,944.66
Michigan	3,834,438	16,089.18	2,186,780	57.03	19,764.13
Minnesota	2,044,271	14,320.60	948,847	46.41	18,175.15
Mississippi	905,415	14,330.70	463,077	51.15	17,580.60
Missouri	2,181,437	14,619.46	1,067,483	48.96	18,384.10
Montana	341,499	13,983.09	129,654	37.97	18,329.36
Nebraska	705,704	12,567.07	313,802	44.47	15,943.55
Nevada	465,231	16,656.75	226,453	48.68	20,054.66
New Hampshire	418,775	14,984.99	222,973	53.24	18,468.86
New Jersey	3,321,398	17,770.43	1,833,111	55.19	21,997.13
New Mexico	538,119	15,028.49	252,578	46.94	18,053.48
New York	7,007,157	16,719.06	4,033,309	57.56	19,916.23
North Carolina	2,657,459	13,560.47	1,325,530	49.88	16,608.67
North Dakota	273,672	13,694.05	105,164	38.43	18,372.76
Ohio	4,660,579	16,162.00	2,836,462	60.86	19,416.11
Oklahoma	1,334,765	15,899.90	529,199	38.22	20,406.19
Oregon	1,212,738	15,787.53	632,292	51.40	19,517.86
Pennsylvania	4,857,542	15,178.87	2,815,101	57.95	17,983.65
Rhode Island	411,074	13,213.83	216,608	52.69	16,162.88
South Carolina	1,350,111	12,063.77	557,461	41.29	15,666.63
South Dakota	306,577	13,324.42	140,708	45.90	16,091.66
Tennessee	1,917,291	16,095.64	1,104,164	57.59	19,933.13
Texas	6,790,184	17,068.25	3,138,359	46.22	20,709.91
Utah	625,403	14,830.72	307,062	49.10	19,841.73
Vermont	232,956	12,807.08	118,869	51.03	15,845.11
Virginia	2,610,484	16,924.21	1,563,969	59.91	20,143.66
Washington	1,696,329	16,319.99	819,390	48.30	20,892.39
West Virginia	669,238	13,918.09	378,752	56.59	17,175.54
Wisconsin	2,275,370	14,492.64	1,304,692	57.34	18,593.45
Wyoming	211,770	15,701.05	99,234	46.86	20,557.27

Note.—The Census Bureau recommends a minimum population of 75,000 for statistical reliability.

Source: EBRI tabulations of the May 1983 EBRI/HHS Current Population Survey Pension Supplement.

TABLE 2.—1983 EBRI/HHS CURRENT POPULATION SURVEY MAY PENSION SUPPLEMENT EMPLOYEE BENEFIT UTILIZATION

State	Civilian work force	Average income	Health plan		Average income
			Primary	Percent with	
Total	98,963.82	$15,961.27	59,041,441	59.66	$19,332.44
Alabama	1,412,880	14,604.37	774,513	54.82	17,364.11
Alaska	169,352	23,863.26	93,161	55.01	27,349.61
Arizona	1,220,314	16,141.71	684,885	56.12	28,435.16
Arkansas	892,638	11,562.23	431,437	48.33	13,866.56
California	10,552,286	18,168.23	6,399,558	60.65	21,763.25
Colorado	1,461,703	17,861.65	766,589	52.44	21,251.12
Connecticut	1,514,791	18,858.37	955,953	63.11	22,539.62
Delaware	277,260	16,710,20	183,034	66.02	20,215.84
District of Columbia	262,714	17,309.46	158,379	60.29	19,001.31
Florida	4,506,621	13,487.39	2,336,052	51.84	15,964.23
Georgia	2,432,688	13,829.38	1,450,845	59.64	16,423.64
Hawaii	470,799	16,031.15	293,912	62.43	18,862.92
Idaho	366,862	15,263.51	216,208	58.93	18,584.26
Illinois	4,867,743	17,600.74	3,201,410	65.77	28,617.00
Indiana	2,384,353	14,765.10	1,414,632	61.39	18,273.29
Iowa	1,228,463	14,360.88	610,163	49.67	18,852.15
Kansas	1,049,375	14,713.55	576,934	54.98	18,483.55
Kentucky	1,345,239	13,924.41	806,543	59.96	16,486.96
Louisiana	1,528,105	14,750.59	866,594	56.71	18,587.14
Maine	530,634	13,192.55	301,677	56.85	15,917.77
Maryland	2,009,861	18,461.43	1,247,504	62.09	22,370.62
Massachusetts	2,653,158	16,368.66	1,670,139	62.95	19,420.26
Michigan	3,834,438	16,089.18	2,338,736	60.99	20,457.46
Minnesota	2,044,271	14,320.60	1,046,086	51.17	19,166.23
Mississippi	905,415	14,380.70	517,032	57.10	16,346.60
Missouri	2,180,437	14,619.46	1,223,691	56.12	18,143.32
Montana	341,499	13,983.09	128,520	37.63	19,409.95
Nebraska	705,704	12,567.07	347,126	49.19	16,592.04
Nevada	465,231	16,656.75	388,700	66.35	18,825.06
New Hampshire	418,775	14,934.99	247,532	59.11	18,653.86
New Jersey	3,321,398	17,770.43	2,136,953	64.34	21,061.10
New Mexico	539,119	15,028.49	275,217	51.14	18,401.10
New York	7,007,157	16,719.06	4,592,845	65.55	19,731.58
North Carolina	2,657,459	13,560.47	1,675,203	63.04	16,272.13
North Dakota	273,672	13,694.05	112,634	41.16	19,120.32
Ohio	4,660,579	16,162.00	2,987,831	64.11	19,354.30
Oklahoma	1,384,765	15,899,90	666,091	48.10	19,910.57
Oregon	1,212,738	15,787.53	718,674	59.26	18,962.51
Pennsylvania	4,857,542	15,178.87	3,134,437	64.53	18,062.63
Rhode Island	411,074	13,213.83	246,593	59.99	15,820.60
South Carolina	1,350,111	12,063.77	792,912	58.73	14,540.03
South Dakota	306,577	13,324.42	140,853	45.94	17,122.76
Tennessee	1,917,291	16,095.64	1,201,478	62.67	18,499.87
Texas	6,790,184	17,068.25	3,905,203	57.51	20,123.29
Utah	625,403	14,830.72	335,463	53.64	19,147.81
Vermont	232,956	12,807.08	132,438	56.85	15,662.30
Virginia	2,610,484	16,924.21	1,598,847	61.25	20,417.09
Washington	1,696,329	16,319.99	896,364	52.84	20,872.24
West Virginia	669,238	13,918.09	407,751	60.93	17,056.45
Wisconsin	2,275,370	14,492.64	1,382,599	60.76	18,650.03
Wyoming	211,770	15,701.05	103,112	48.69	20,896.87

Note.—The Census Bureau recommends a minimum population of 75,000 for statistical reliability.

Source: EBRI tabulations of the May 1983 EBRI/HHS Current Population Survey Pension Supplement.

TABLE 3.—1983 EBRI/HHS CURRENT POPULATION SURVEY MAY PENSION SUPPLEMENT EMPLOYEE BENEFIT UTILIZATION

State	Civilian work force	Average income	ERISA work force	Average income	Pension coverage	Percent covered	Average income
Total	98,963,821	$15,960.27	54,362,744	$19,378.80	38,057,537	70.010	$21,166.48
Alabama	1,412,880	14,604.37	774,339	16,868.74	484,539	62.57	19,016.61
Alaska	169,352	23,868.26	81,300	27,071.54	57,594	70.84	28,669.82
Arizona	1,220,314	16,141.70	667,093	19,921.34	459,219	68.84	21,292.00
Arkansas	392,638	11,562.23	363,465	15,282.54	223,798	61.57	15,739.10
California	10,552,286	18,168.23	5,484,205	21,969.84	3,778,985	68.91	23,951.62
Colorado	1,461,703	17,061.65	772,081	20,730.85	513,164	66.47	23,304.89
Connecticut	1,514,791	18,858.37	952,482	22,325.71	718,773	75.46	23,737.50
Delaware	277,260	16,710.20	171,231	20,628.45	140,699	82.17	21,063.43
District of Columbia	266,714	17,309.46	167,548	18,097.93	110,027	65.59	19,491.42
Florida	4,526,621	13,487.39	2,234,232	16,020.31	1,202,542	53.82	17,901.98
Georgia	2,432,688	13,829.38	1,289,109	16,502.99	877,787	68.09	17,896.62
Hawaii	470,799	16,031.15	292,597	19,426.50	210,950	72.10	20,580.43
Idaho	366,862	15,263.51	178,440	19,445.77	133,701	74.93	21,270.81
Illinois	4,367,743	17,600.74	2,963.784	20,549.69	2,126.014	71.73	22,491.38
Indiana	2,914,353	14,765.10	1,327,223	17,983.85	972,379	73.26	19,039.07
Iowa	1,228,463	14,330.88	526,866	18,618.23	405,260	76.92	19,866.17
Kansas	1,149,375	14,713.55	533,153	18,457.64	339,157	63.61	20,147.28
Kentucky	1,1345,239	13,924.41	782,846	16,536.73	546,837	69.85	18,327.52
Louisiana	1,528,105	14,750.59	821,887	18,058.14	489,681	59.58	20,208.92
Maine	530,634	13,192.55	296,315	16,035.19	186,154	62.82	17,892.38
Maryland	2,119,861	18,461.43	1,248,909	22,206.18	938,236	75.12	24,146.18
Massachusetts	2,653,158	16,368.66	1,532,262	19,765.88	1,106,403	72.21	20,980.19
Michigan	3,834,438	16,089.18	2,219,312	20,331.03	1,681,127	75.75	22,077.82
Minnesota	2,144,271	14,321.60	1,053,306	18,612.43	682,003	64.75	20,881.53
Mississippi	915,415	14,380.70	489,501	16,078.43	338,417	69.14	17,793.62
Missouri	2,180,437	14,619.46	1,181,647	18,334.42	797,335	67.48	20,434.97
Montana	341,499	13,983.19	122,143	19,309.33	85,956	70.37	21,165.51
Nebraska	715,714	12,567.07	335,143	16,086.79	223,303	66.63	17,829.30
Nevada	465,231	16,656.75	267,494	19,543.12	173,975	65.04	20,466.71
New Hampshire	418,775	14,934.99	239,522	18,078.63	173,512	72.44	19,791.96
New Jersey	3,321,393	17,770.43	1,889,361	22,216.54	1,333,437	70.58	24,222.86
New Mexico	538,119	15,028.49	299,378	17,987.14	206,446	68.96	18,852.68
New York	7,007,157	16,719.06	4,194,111	19,802.31	3,046,319	72.63	21,591.80
North Carolina	2,657,459	13,560.47	1,557,778	16,345.64	1,046,607	67.19	17,556.13
North Dakota	273,672	13,694.05	114,533	17,975.88	66,176	57.78	20,275.66
Ohio	4,660,579	16,162.00	2,756,113	19,517.18	2,134,179	77.43	21,125.85
Oklahoma	1,384,765	15,899.90	613,565	21,159.71	381,158	62.12	22,351.84
Oregon	1,212,738	15,787.53	656,610	19,189.44	474,721	72.30	20,878.66
Pennsylvania	4,857,542	15,178.87	2,890,330	18,099.61	2,164,065	74.87	19,454.68
Rhode Island	411,074	13,213.83	205,439	17,358.68	146,356	71.24	18,997.68
South Carolina	1,350,111	12,063.77	751,038	14,301.93	438,610	58.40	16,094.06
South Dakota	306,577	13,324.42	136,198	16,586.57	95,060	69.80	18,262.97
Tennessee	1,917,291	16,095.64	1,097,406	18,704.91	828,443	75.49	20,569.37
Texas	6,790,184	17,068.25	3,352,688	20,325.04	2,131,402	63.57	22,323.02
Utah	625,403	14,830.72	275,742	19,393.78	192,724	69.89	21,503.34
Vermont	232,956	12,807.08	125,188	15,984.30	83,681	66.84	17,506.07
Virginia	2,610,484	16,924.21	1,528,784	20,398.92	1,155,838	75.61	22,414.55
Washington	1,696,329	16,319.99	848,408	21,075.30	630,601	74.33	22,315.29
West Virginia	669,238	13,918.09	377,200	17,176.74	302,197	80.12	18,286.70
Wisconsin	2,275,370	14,492.64	1,228,703	18,775.41	995,833	77.79	20,246.15
Wyoming	211,771	15,701.05	94,775	20,325.34	66,193	69.84	22,437.38

Note.—The Census Bureau recommends a minimum population of 75,000 for statistical reliability.

Source: EBRI tabulations of the May 1983 EBRI/HHS Current Population Survey Pension Supplement.

TABLE 4.—1983 EBRI/HHS CURRENT POPULATION SURVEY MAY PENSION SUPPLEMENT EMPLOYEE BENEFIT UTILIZATION

State	Civilian work force	Average income	ERISA work force		
			Health plan		Average income
			Primary	With percent	
Total	98,963,821	$15,960.27	45,160,894	83.07	$28,734.21
Alabama	1,412,880	14,604,37	569,747	73.58	18,510.95
Alaska	169,352	23,868.26	66,549	81.86	29,024.20
Arizona	1,220,314	16,141.70	531,496	79.67	21,493.62
Arkansas	892,638	11,562.23	291,268	80.14	15,757.42
California	10,552,286	18,168.23	4,588,340	83.66	23,495.02
Colorado	1,461,703	17,061.65	572,568	74.16	23,094.96
Connecticut	1,514,791	18,858.37	801,456	84.14	23,732.12
Delaware	277,260	16,710.20	143,008	83.52	22,301.50
District of Columbia	262,714	17,309.46	124,251	74.18	19,558.34
Florida	4,506,621	13,487.39	1,721,981	77.07	17,119.02
Georgia	2,432,683	13,829.38	1,092,468	84.75	17,506.45
Hawaii	470,799	16,031.15	232,651	79.51	20,692.45
Idaho	366,862	15,263.51	156,292	87.59	20,153.56
Illinois	4,867,743	17,600.74	2,569,753	86.71	21,792.42
Indiana	2,304,353	14,765.10	1,128,763	85.05	19,045.13
Iowa	1,228,463	14,360.88	409,750	77.77	20,891.32
Kansas	1,049,375	14,713.55	425,599	79.83	20,211.46
Kentucky	1,345,239	13,924.41	664,969	84.94	17,290.11
Louisiana	1,528,105	14,750.59	656,898	79.93	20,022.05
Maine	530,634	13,192.55	242,288	81.77	17,168.03
Maryland	2,009,861	18,461.43	1,011,979	81.03	23,892.17
Massachusetts	2,653,158	16,368.66	1,311,252	85.58	20,909.50
Michigan	3,834,438	16,089.18	1,893,761	85.33	21,740.95
Minnesota	2,544,271	14,320.60	829,189	78.72	20,546.37
Mississippi	905,415	14,330.70	398,493	81.41	17,347.59
Missouri	2,180,437	14,619.46	957,189	81.00	19,798.14
Montana	341,499	13,983.09	92,714	75.91	21,376.07
Nebraska	705,704	12,567.07	250,316	74.69	17,905.66
Nevada	465,231	16,656.75	229,172	85.67	19,943.17
New Hampshire	418,775	14,984.99	196.420	82.00	19,895.89
New Jersey	3,321,398	17,770.43	1,612,508	85.35	23,202.26
New Mexico	538,119	15,028.49	223.424	74.63	19,664.96
New York	7,007,157	16,719.06	3,535,500	84.30	21,118.38
North Carolina	2,657,459	13,560.47	1,387,002	89.04	17,085.83
North Dakota	273,672	13,694.05	83,320	72.75	20,552.64
Ohio	4,660,579	16,162.00	2,325,871	84.39	20,950.42
Oklahoma	1,384,765	15,899.90	479,661	78.18	21,990.53
Oregon	1,212,738	15,787.53	546,769	83.27	20,536.83
Pennsylvania	4,857,542	15,178.87	2,494,876	86.32	19,161.81
Rhode Island	411,074	13,213.83	171,511	83.49	18,506.04
South Carolina	1,350,111	12,063.77	607,919	80.94	15,091.02
South Dakota	306,577	13,324.42	102,602	75.33	18,678.21
Tennessee	1,917,291	16,095.64	926,510	84.43	20,273.86
Texas	6,790,184	17,068.25	2,761,028	82.35	21,599.85
Utah	625,403	14,830.72	234,396	85.01	20,749.61
Vermont	232,956	12,807.08	104,022	83.09	16,726.53
Virginia	2,610,484	16,924.21	1,268,598	82.98	21,779.91
Washington	1,696,329	16,319.99	696,516	82.10	22,068.97
West Virginia	669,238	13,918.09	320,642	85.01	18,411.75
Wisconsin	2,275,370	14,492.64	1,042,606	84.85	20,472.94
Wyoming	211,770	15,701.05	75,030	79.17	21,951.81

Note.—The Census Bureau recommends a minimum population of 75,000 for statistical reliability.

Source: EBRI tabulations of the May EBRI/HHS Current Population Survey Pension Supplement.

Chairman PICKLE. We thank you.

Mr. Salisbury, I said at the beginning, and I am pleased to comment again, that the Employee Benefit Research Institution has always given us good information. I know yours is a factual research committee and you do not often go into the areas of recommendations. In your testimony, do you make any recommendations as to course of action or do you just make an analysis?

Mr. SALISBURY. The Institute, Mr. Chairman, is a nonpartisan, nonprofit research organization, and one of the aspects of our charter is we do not make policy recommendations. We attempt to provide the research analysis in response to specific questions from the committee and others.

Chairman PICKLE. The charts and the testimony you have submitted are extremely valuable to us and we thank you.

Now we will hear from a good and dear and old friend, Donald Alexander, representing the U.S. Chamber of Commerce. Mr. Alexander.

STATEMENT OF DONALD C. ALEXANDER, ON BEHALF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY MICHAEL J. ROMIG, DIRECTOR, EMPLOYEE BENEFITS AND HUMAN RESOURCES POLICY CENTER

Mr. ALEXANDER. Thank you. I am Don Alexander with the law firm of Morgan, Lewis & Bockius, here today for the chamber of commerce. With me is Michael Romig, chairman of employee benefits for pension policies for the chamber. Behind us is Dr. James Morris, who has much to do today with the chamber's survey, on which you have asked us to comment.

I want to join with Dallas Salisbury, who very carefully didn't say anything about policy. I think we do have a good program in place, Mr. Chairman, that delivers much in the way of needed benefits and security to many, in a comprehensive and fair way, at comparatively little cost to the revenues. That is the chamber's position in general.

Now one point should be kept in mind, that is, as the Treasury pointed out in its statement yesterday, Congress has already acted. You acted in 1984 with respect to involuntary employee beneficiaries associations and cafeteria plans. You considered and rejected a cap on health care, and a cap has many problems, as Dallas Salisbury pointed out so well. It doesn't necessarily accomplish what it sets out to accomplish, but it can accomplish much in the way of harm, by reason of the fact that a cap is uniform, and geographical and industry and age needs are not uniform.

The chamber suggests that the solution to the concern about growth in nontaxable benefits be sought first in analyzing what is really likely to happen, and what has happened already. Has it been a slowdown in this growth? Are there other and better means of controlling the expanding costs of health care?

Some of those means were suggested yesterday, and Dr. Helms pointed out, by the way, in language which is better than mine, that our diverse and dynamic system of private insurance "was not just a suitable model but was in fact a superior system to a monolithic national health insurance scheme," and the same thing is true in the other areas of concern to this committee, and of concern to the chamber.

The chamber's concern has manifested itself by the fact that over 20 years ago the chamber noted a great lack of statistical information about the scope and nature of employee benefits, and therefore instituted a biennial survey. That survey was not scientific when started, but it is comprehensive and carried out on a scientific bases now. It bears out the points that Dallas Salisbury made, that indeed coverage is very wide, although in the small business area not as wide as we would want. That, indeed, benefits do not favor the wealthy, but instead there is an inverse correlation, as Dallas Salisbury told you a few minutes ago.

Given the system in place, given the fact that it works, given the fact that it delivers much to many at comparatively little cost, and given the great pressure that would be placed on Congress to provide a supplemental system if tax incentives were removed, the chamber hopes that other ways, better ways, will be found to control expanding costs, which indeed have slowed down and that the 1984 act will be given a chance to work, before Congress again revisits the general area of employee benefits.

Now you are going to revisit two areas, I understand, tomorrow, and they deserve revisiting. One of these is educational benefits and the other group legal services. The chamber supports the bills that have been introduced to continue one program and renew the other.

Mr. Chairman, instead of attempting to respond orderly to each of the questions which the subcommittee has posed, we respond to those questions in the written statement, which I request be made a part of your record, and we will be glad to respond in detail, if you have further questions in addition to what we have submitted.

[The prepared statement follows:]

STATEMENT OF DONALD C. ALEXANDER, COUNSEL, CHAMBER OF COMMERCE OF THE UNITED STATES

I am Donald C. Alexander of the law firm of Morgan, Lewis & Bockius. I appear today on behalf of the U.S. Chamber of Commerce and its 200,000 business members. I serve on the Chamber's Board of Directors, on its Employee Benefits Committee, where I chair the Employee Benefits Taxation Subcommittee, and on its Taxation Committee. With me this morning is Michael J. Romig, Manager of Employee Benefits and Pension Policy for the Chamber.

We welcome the opportunity to express the Chamber's support for a strong, voluntary, private sector employee benefit system and a tax policy that both recognizes the valuable contributions that employee benefits make to our collective economic security and encourages employee benefit plan sponsors to assume this awesome responsibility.

In the face of large budget deficits and increasing questions about the ability of our public programs to meet the increasing needs of an expanding elderly population, these hearings offer a much-needed opportunity to evaluate how well our tax policy stimulates employee benefits to complement Social Security, Medicare and other public entitlement programs, and how well these private programs are performing. Your Subcommittees are to be congratulated for initiating this inquiry. The excellent questions you have posed deserve careful reply. The Chamber hopes that the answers you elicit will lead you to reaffirm the current employee benefit tax incentives.

WHAT OUR EMPLOYEE BENEFITS SYSTEM HAS ACCOMPLISHED

Before we attempt to respond to these questions, it might be useful for your evaluation to review the overall accomplishments of the employee benefit system.

1. Substantial risk protection for more than 30 years. Private employee benefit programs have provided substantial risk protection to American workers and their families for more than 30 years. These programs are broadly-based in terms of numbers of participants and beneficiaries affected. They provide pension, medical, disability and life insurance coverage primarily to middle-income workers and their dependents. More recently, employee benefits are also being used to protect against layoffs, unanticipated emergency expenses and other risks.

Surveys show that employee benefit coverage protects over 150 million employees and their dependents and over one million employers are providing retirement and welfare plan benefits. Employee Benefit Research Institute (EBRI) has found that almost 95% of all full-time non-agricultural employees in medium to large size firms enjoy life, health and disability insurance and that 75% of these employees are participants in retirement benefit plans.

Equally important is the fact that these benefits are broadly available across the workforce and no limited to the highly paid. Over three-fourths of the employees participating in private pensions earn less than $25,000. Among employees with vested pension rights, 70% earn less than $25,000. As for health insurance, 80% earn less than $25,000.

2. Maintenance of a less extensive and less costly Social Security system and avoidance of the burdens and problems of a broadly-based national health system. During the last 30 years, private employee benefit programs have assisted in the growth of the most advanced health care delivery system and the largest private pension system in the world. They have permitted our government to avoid much of the burden and problems that other developed nations have experienced in implementing national retirement and health care systems. This U.S. policy for a public-private partnership for meeting national economic security needs has been so successful that other nations are moving in our direction. In hindsight, the early Congressional advocates of our system were clairvoyant when they argued that the alternatives would be many times more expensive. A particularly noteworthy example is the level and extent of private health insurance that is being provided at comparatively modest revenue reduction.

3. Government and private sector cooperation. Experience has shown that governmental programs for the delivery of services often produce a uniform system of benefits delivered with heavy administrative costs. Such a system is frequently inefficient and laden with questionable procedures and inadequate delivery systems that serve to frustrate employers, employees and beneficiaries.

Under current law, employers have voluntarily established a diverse but comprehensive private system, with minimal federal guidelines, that serves the needs of our diverse workforce. The result is a flexible system that serves the country well.

4. Encouragement of a sense of affiliation with the employer leading to increased employee productivity. Employee benefit plans, provided on a voluntary basis by employers, create an important bond between employers and employees. Employer sponsorship gives employees a greater sense of their role in the success of the enterprise and provides them with a greater stake in the outcome of the economic activities of their employer.

5. Important source of savings and investment. Institutional investors have become the single most important source of capital to the financial markets. Retirement funds have become the largest single component of this institutional investment. In this regard, it is noteworthy that the objective of building pools of investment capital was one of the underlying motives for the adoption of some of the tax incentives offered with respect to private retirement programs.

THE GROWTH AND COMPOSITION OF EMPLOYEE BENEFITS

Since 1951, the U.S. Chamber of Commerce has conducted one of the most comprehensive surveys of employee benefits. Over 20 years ago, we noted the scarcity of statistical information about the scope and nature of employee benefits and we decided to conduct biennial surveys on how much employers were spending for various employee benefits and what they were spending it on. Since 1977, we have conducted this survey on an annual basis. Our latest survey, the twenty-first, presents data collected for calendar year 1982. Copies have been presented to the members and staff of the Subcommittees.

A description of how the survey is conducted and how the figures are computed may be found at page 31 of the 1982 Survey. The actual questionnaire appears at pp. 32–34. You will also find a description of some of the practical limits on the use of this data, primarily that the 1982 sample is much larger and more representative of the business community than in the past, including for the first time firms with fewer than 100 employees. On the other hand, agriculture is not included, and the survey is directed in general to companies to which the Fair Labor Standards Act applies. However, the large number of participating firms, and the diversity in size, industry and geographic distribution make this a fair representation of what employee benefits are available and the extent to which such benefits are provided.

In 1981, we also published a historical summary of the surveys between 1951 and 1979, copies of which have been provided to the members and staffs of the Subcommittes. This survey might be helpful in illustrating how employee benefits have responded to changes in the tax treatment and/or regulation of specific employee benefit arrangements. In responding to the questions posed by the Subcommittees, we will highlight those aspects of our survey that appear to be on point.

SUMMARY OF FINDINGS

These reports trace the growth of employee benefits from 18.7% of payroll in 1951 to 36.7% of payroll in 1982. As dollars per year per employee, the increase was from $644 in 1951 to $7,187 in 1982. While the growth would appear spectacular, it is much less pronounced when expressed in real dollars—from $2,393 in 1951 to $7,197 in 1982. Moreover, the growth rates have tailed off significantly since 1977, although some individual benefits have been rising slowly. (See Charts 4 and 5 of Historical Data).

We believe this benefit growth is attributable to the following factors: First, new benefits have been introduced. Vision and dental insurance, group legal and education assistance are examples. Second, benefits have increased significantly in cost. For example, the employer share of Social Security in 1951 was 3% on the first $3,600 in wages. Today it is 7% on the first $37,800. Third, the duration of benefits has increased, as evidenced by the step-up in holidays and vacation time. Fourth, the number of covered employees has increased as a result of expanded government requirements for participation in Social Security, Medicare, Unemployment and Workers' Compensation and private pensions.

Another important finding of our surveys is that employer payments varied widely among the firms reporting, with lesser degrees of variation among industries, size of business and geographic region. Over time, the variations appear to remain unchanged, i.e. larger firms consistently paid more than nonmanufacturing firms. (See Table 12 of Historical Data and Table 6 of Employee Benefits 1982).

REALITIES OF TAX-FREE BENEFITS

Neither survey attempts to break down these employee benefits by how they are taxed. As a consequence, many incorrectly assume that all employee benefits are tax-free when in fact only a small fraction of these benefits are free of income tax. Table 1 and Chart I of the Data Supplement attached to our testimony show the breakdown of our survey data. While total employee benefits amount to 32.5% of wages and salaries, tax-favored benefits amount to only 9% of wages and salaries. Table 2 divides tax-favored benefits into tax-exempt and tax-deferred benefits. Note that tax-exempt benefits are only 4.6% of wages and salaries, not the ⅓ figure that some have assumed.

In Table 6, we present our 1982 survey data grouped by tax treatment (under current law) and contrast this with data from our 1971 survey to illustrate the growth of taxable tax-exempt benefits. While the growth of tax-exempt benefits outpaces both taxable benefits and wages, it still remains a small portion of wages and total benefits.

SUBCOMMITTEE QUESTIONS

(1) How prevalent are the available fringe benefits? Specifically, what percent of the work force is covered by the various fringe benefits, such as pensions, and what percent of compensation do fringe benefits represent? How does this compare with their historic availability and utilization, and what changes are currently projected to occur in the future?

Employee benefits are widely available. According to our 1982 Survey (Table 15, page 21), 83% of all reporting companies offer a pension to their employees, 99% offer health and life insurance, but only 15% offer discounts on company goods and services.

Because our survey measures what benefits are being offered, by what firms and how much they cost, it is not an accurate gauge of the percentage of the workforce covered by each employee benefit. Other surveys, however, provide a glimpse into the prevalence of various benefits. For example, resarch conducted for EBRI found that 75% of all full-time employees over 25 years of age were participating in pensions in 1979. Another EBRI study projected that almost 97% of workers and their families are covered by group health insurance. The EBRI data is supported by a recently-published survey issued by the Bureau of Labor Statistics and covering 20 million workers of medium and large-size firms for 1983.

As for historic patterns, our Historical Data survey provides an insight into how prevalent these benefits have been over the years. Table 5 (at page 14) reveals that since 1955, more than 96% of the surveyed firms have offered life and health insurance and this has risen to almost 100% since 1975. Pensions, on the other hand, moved from 75% of the firms to a high of 91% in 1977 and fell to 86% in 1979. Our current survey reveals a further drop to 83% of the surveyed firms. Although the survey does not explain this trend, we are of the opinion that the increasing complexity, cost and potential liability of sponsoring a pension are the root cause of the drop in firms providing pension benefits. Much of this complexity arose with ERISA and subsequent tax laws, all of which were enacted during the period of the reported decrease. Some companies now rely primarily on profit sharing plans and cash-or-deferred plans to deliver retirement income.

If we want to end this apparent decline in pension plans, it appears that a moratorium on new pension laws is in order.

(2) Which employees by salary range and occupation receive the various fringe benefits?

The Chamber's surveys do not provide this information, but we are aware of EBRI surveys that do.

However, a comment is in order. Basic employee benefits must be provided on a nondiscriminatory basis. As a result, employee benefits are widely distributed among workers and their families at all income levels. Because many employees earn less than $25,000, it is not surprising to note that they make up the overwhelming majority of those who participate and receive employee benefits. Hence, the notion that only the highly paid get tax-favored benefits is far off target.

(3)(a) Since different types of fringe benefits are subject to different tax treatment, how do employers and employees decide to structure a total compensation package which includes cash, taxable fringes and nontaxable fringes?

Decisions on how to structure a total compensation package (cash, taxable and nontaxable employee benefits) are made after weighing many factors, an important one being tax consequences.

Employee compensation serves to attract, retain and motivate productive employees. Hence, a firm should offer a package that meets employee needs and expectations, competes effectively with other firms and is within a cost level that allows the firm to market its goods or services at a reasonable price. In deciding how to meet these objectives, a company takes tax considerations into account.

(3)(b) What is the effect of tax-favored treatment on the selection of certain fringe benefits in comparison to other fringe benefits and cash remuneration? What would be the effect [on] the availability and use of various fringe benefits if the favorable tax treatment were changed, for instance, if FICA tax were imposed?

Unquestionably, a tax-favored employee benefit has added attraction for both employee and employer but, for each, there are limits on the extent of this attraction. For example, no one would want all of his or her compensation package limited to health insurance simply because it is tax-favored.

As the Chamber's surveys confirm, changing the tax treatment of an employee benefit has an influence on employer and employee behavior. For example, in 1978 employee education benefits were accorded tax-exempt status. Our surveys show that employers offering this benefit increased from 34% to 63% of the companies surveyed. The provision granting tax-favored treatment has now expired. Unless Congress renews this favorable tax treatment—as we recommend—we expect to see a drop-off in the number of firms offering education assistance and a reduction in a valuable and needed benefit.

If only FICA taxes were imposed on an employee benefit that was previously tax-exempt, then the behavioral response would be less, since the FICA tax rate is only 7%. But even in this situation, another 7% must be paid by the employer and the cost of the benefit will increase for the employer by at least 7%. This burden may be enough to cause an employer to abandon such benefit.

(4) What are the economic effects of the utilization of fringe benefits? What is the effect of the tax-favored treatment of certain fringe benefits on the horizontal and vertical equity of the income tax system? For example, for any given level of overall federal revenue, would the incidence of the income tax shift significantly if currently nontaxable fringe benefits were subject to income taxes?

Employee benefits have become a vital aspect of the lives of most Americans and an important element of the compensation structure and planning of a great majority of American employers. Government, too, has come to depend on employee benefits both in its capacity as an employer and in fulfilling obligations to provide for the security and welfare of the populace. Thus, employee benefits are an essential aspect of our nation's social and political life as well as its economic life.

Pensions, disability, life and health insurance provide indispensible complements to Social Security, Disability Insurance and Medicare. Federal, state and local laws have been drawn to encourage the provision of employee benefits across a broad cross-section of our populace and have fashioned their social programs and priorities accordingly. If such supportive government policies were to be withdrawn or revised significantly, massive economic dislocation would result.

Studies by the U.S. Department of the Treasury and others reveal that employee benefit tax incentives, although among the largest of the so-called tax expenditures, are very efficient at meeting tax policy objectives. Pensions, on which there is increasing information, provide an excellent example.

First, the number of pension plans has grown significantly in response to the favorable tax treatment, from less than a thousand prior to WWII to over 800,000. (See Table 3 in our Data Supplement).

Second, because pensions and other employee benefits must be provided on a nondiscriminatory basis, the distribution of the coverage, vesting and payment of pension and other benefits generally tracks the composition of our nation's workforce. Because pension coverage, participation and vesting are related to age and years of service, and retirement income is reasonably related to compensation, the data shows a correlation between income earnings and pension benefits. (Table 4 in our data supplement illustrates this distribution)

A study performed by the Treasury Department in 1982 found that the value to workers of the tax exclusion closely follows overall tax liability. In fact, the study demonstrates that, contrary to popular opinion, the bulk of the tax benefit derived from pensions goes to the middle class. (See Table 5 in the Data Supplement). Removing the tax-favored treatment would shift the tax burden little, but increase it greatly.

(5) How much could FICA tax rates be lowered if nontaxable benefits were included in the social security wage base? What is the effect of the exclusion of certain fringe benefits from the social security wage base on social security benefits received by various types of workers?

When public attention focused on options for rescuing Social Security, one of the questions raised was whether the growth of nontaxable employee benefits threatened the financial security of Social Security and Medicare. In its annual report for 1984, the Social Security Trustees projected a straight-line decline in the total compensation subject to the FICA tax. As you know the Trustees' assumption is for the ratio of wages to total employee compensation to decline from about .8 to .6 by 2060. This assumes that the growth of employee benefit that has occurred since 1950 will continue, a highly unrealistic notion.

If one accepts this data, one might assume that FICA revenues would increase by 20% if all nontaxable benefits were made subject to the FICA. Congress could then reduce FICA tax rates by that factor and still be assured that Social Security revenues would increase because the anticipated future erosion of the tax base would not occur.

If so, why did Congress not pursue this apparently simple solution?

The answer can be found in the fact that the underlying assumptions were challenged—largely on the three grounds. First, the assumption of future erosion was unsupportable, since it assumed that there would be no limit on people's desire to avoid FICA taxes. Second, the assumptions wrongly concluded that tax treatment is irrelevant; that employers would continue to offer and employees would continue to use these benefits to the same extent once they became taxable. Third, the data itself overstated the amount of tax-exempt benefits. Rather than limiting itself to discretionary tax-exempt benefits, it included non-discretionary tax-exempt benefits as well. Finally, it is not realistic to assume that income and revenues would not be offset by increased costs; if private benefits were curtailed, pressure for increased public benefits would likely be irresistible.

(6) What would be the effect of placing a fixed dollar cap, flat excise tax, or a limit on the percent of compensation which could be accorded tax-exempt or tax-deferred treatment? What levels or limits would be necessary in order to prevent further erosion of tax bases?

As indicated above, the Social Security Trustees' assumptions of the erosion of the tax base must be questioned and therefore ought not to be used as a primary basis for tax policy decisions. Whether or not benefits are taxed should be independently decided and not based entirely on projection of the tax base for Social Security.

The Chamber believes that imposition of an overall percentage ceiling or fixed dollar cap on tax-exempt benefits would be an inefficient and arbitrary policy tool. So would the imposition of an excise tax on employers who provide these benefits. Since we have demonstrated that discretionary tax-exempt benefits average only 9% of wages, any limit would have to be set at a point above that level. A cap or excise tax would penalize older workers, workers in high risk occupations, workers with particular family needs and those in certain areas of the country. The Chamber opposes this concept.

(7) What is the relationship between fringe benefits provided by employers and social programs provided by government agencies? What social purposes are served by various fringes? If certain fringe benefits were not provided by employers, would there be an increased dependency on existing federally funded social programs or a need to create federally funded social programs? Which is the most efficient use of resources in providing specific services or benefits: encouraging employers to provide them through perferred tax treatment or providing them through directly funded public programs?

Throughout our testimony, we have reviewed the connection between public social programs and private employee benefits. Recent history is replete with conscious public policy decisions to foster complementary programs. We believe that any fair assessment shows that America has a tremendous success story in its public-private partnership for economic security.

Alone, neither public nor private programs can perform effectively: When one contracts the other expands. However, the response is not totally elastic, and at some point the continued contraction of one program might overwhelm the other. The recent Medicare contraction vividly illustrates how private programs increase in response to curtailment of public programs.

The Chamber believes that the private sector works more efficiently than the public sector, and thus, programs aimed at economic security should rely on the private sector to the maximum feasible extent. In this case, a partnership between the public and private sectors is needed. We are also convinced that without favorable tax incentives for employee benefits, public expenditures for Social Security and Medicare would grow significantly. A reduction or elimination of the favorable tax treatment accorded to employee benefits would erode the contribution they make to economic security.

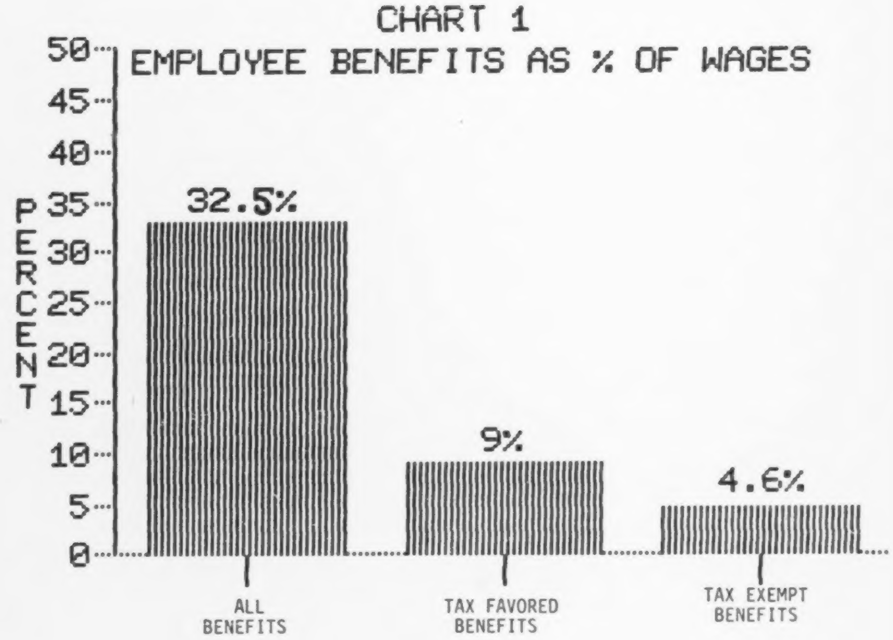

CHART 1
EMPLOYEE BENEFITS AS % OF WAGES

TABLE 1
Composition of Employee Benefits by Benefit Group, 1982

Benefit Group	Employer Payments as a Percentage of Wages and Salaries	Employer Payments as a Percentage of All Benefits
Total Benefit Payments	32.5	100.0
Legally Required Employer Payments:	9.5	29.2
Social Security (FICA)	5.2	16.0
Unemployment Compensation	1.1	3.4
Workers' Compensation	0.9	2.8
Other Legally Required Payments[a]	2.3	7.1
Discretionary Taxable Benefits:	13.9	42.8
Time Not Worked[b]	9.8	30.2
Rest Periods	3.8	11.7
Other Taxable Benefits[c]	0.3	0.9
Discretionary Tax-Favored Benefits:	9.0	27.7
Contributions to Pension and Profit-Sharing Plans[d]	4.0	12.3
Group Health, Life, Short-Term Disability Insurance	4.4	13.5
Other Tax-Favored Benefits[e]	0.6	1.8
Summary:		
Legally Required Employer Payments and Discretionary Taxable Benefits	23.5	72.0
All Discretionary Benefits	23.0	61.5
Fully Taxable Benefits	13.9	42.8
Tax-Favored Benefits	9.0	27.7

Source: EBRI tabulation of U.S. Chamber of Commerce estimates in *Employee Benefits 1982* (Washington, D.C.: U.S. Chamber of Commerce, 1983), pp. 11 and 28.

[a] Includes government employee retirement, Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, and state sickness benefits insurance.

[b] Includes paid vacations and payments in lieu of vacation; payments for holidays not worked; paid sick leave; payments for State or National Guard duty; jury, witness, and voting pay allowances; and payments for time lost because of death in family or other personal reasons.

[c] EBRI estimate based on Chamber of Commerce report of amount of Christmas or other special bonuses, service awards, suggestion awards, special wage payments ordered by courts, and payments to union stewards.

[d] EBRI tabulation of Chamber of Commerce estimate of employer contributions to profit-sharing plans.

TABLE 2

Tax-Favored Employee Benefits by Specific Tax Treatment, 1982

Tax Status/ Benefit Group	Employer Contributions as a Percentage of Wages and Salaries	Employer Contributions as a Percentage of All Benefits	Employer Contributions as a Percentage of Tax-Favored Benefits
All Tax-Favored Benefits	9.0	27.7	100.0
Tax-Deferred Benefits:	4.5	13.8	49.5
Pension and profit-sharing plans[a]	4.0	12.3	44.0
Short and long-term disability insurance[a]	0.3	0.9	3.3
Other tax-deferred benefits[a]	0.2	0.6	2.2
Tax-Exempt Benefits:	4.6	14.2	50.5
Contributions to group health and life insurance[b]	4.1	12.6	45.1
Other tax-exempt benefits[c]	0.5	1.5	5.5

Source: EBRI tabulation of U.S. Chamber of Commerce estimates in *Employee Benefits 1982* (Washington, D.C.: U.S. Chamber of Commerce, 1983), pp. 11 and 28.

Note: Figures may not sum to totals due to rounding.

[a] EBRI estimate based on Chamber of Commerce figures.

[b] Estimate includes fully taxable employer payments for life insurance in excess of $50,000.

[c] EBRI estimate of discounts on merchandise, meals furnished by company, payments for vision care and prescription drugs, and moving expenses, based on Chamber of Commerce figures.

TABLE 3

PRIVATE EMPLOYER SPONSORED PENSION PLANS

Year	Plans In Effect
1939	659
1954	24,879
1964	102,626
1974	423,482
1983	803,952

SOURCES: Charles D. Spencer Associates for 1939, 1954, 1964, 1974. EBRI tabulation of IRS data for September 30, 1983.

TABLE 4

PRIVATE PENSION STATUS—MAY 1979[a]

Earnings	Covered	Participating	Vested
$ 1-$4,999	28.9%	14.7%	3.6%
5,000- 9,999	53.0	44.0	17.6
10,000-14,999	71.2	64.5	31.6
15,000-19,999	82.7	77.5	42.5
20,000-24,999	85.3	81.2	47.4
25,000-29,999	87.3	84.6	59.1
30,000-49,999	82.0	78.1	53.9
50,000 and over	88.3	86.2	54.9

[a] Non-agricultural full-time workers age 25-64 with more than 1000 hours of service.

TABLES 3,4 & 5 are from an article by Dallas Salisbury, President of EBRI that appeared in the NATIONAL JOURNAL of April 7, 1984.

TABLE 5

TAX BURDENS AND TAX BENEFITS

Income Class ($000)	Tax Returns	Income	Taxes	Pension Tax Deferral
0-15	51.3%	18.3%	7.9%	9.6%
15-20	11.6	10.7	8.1	7.8
20-30	18.2	23.6	20.8	22.5
30-50	14.5	28.4	30.3	34.1
50-100	3.7	12.4	18.3	17.9
100+	.7	6.6	14.6	8.1

SOURCE: Office of Tax Analysis, Department of Treasury, 1982.

Table 6

WEEKLY EMPLOYEE BENEFITS, per EMPLOYEE 1/
GROUPED BY TAX TREATMENT

	1971	1982	Percent Increase
TAXABLE BENEFITS 2/ (73% of total in 1982)			
Old-age, survivors, disability and health insurance (FICA taxes)	$7.15	$24.50	243%
Private Pensions	7.73	20.00	159
Paid vacations	7.69	17.35	126
Paid holidays.	4.69	10.63	127
Paid sick leave.	1.56	4.69	201
Unemployment compensation. . . .	1.15	5.17	350
Profit-sharing payments.	1.65	4.19	154
Short-term disability.	N.A.	1.25	N.A.
Thrift plans	0.31	1.54	397
Salary continuation or long-term disability	N.A.	1.12	N.A.
Paid rest periods, coffee breaks, lunch periods, etc. .	5.38	10.06	87
Subtotal	37.31	100.50	169%
II STATUTORILY NONTAXABLE BENEFITS (27% of total in 1982)			
Insurance (life, hospital, surgical, medical, etc.) . . .	7.10	24.50	245
Workers' compensation.	1.58	4.96	214
Dental insurance	N.A.	1.60	N.A.
Christmas or other special bonuses, suggestion awards, etc. . . .	0.67	1.19	78
* Employee education expenditures.	0.15	0.88	487
Employee meals furnished free. .	0.25	0.46	84
Discounts on goods and services purchased from company by employees	0.23	0.33	43
Other employee benefits.	1.63	3.79	133
Subtotal	11.61	37.21	220
Total	48.92	138.21	183%
Average weekly earnings	$158.85	$379.79	139%

N.A.: Data not available.

1/ The data presented are from the Chamber's Annual Employee Benefit Surveys.

2/ Tax treatment varies.

* Taxable as of 1984.

EMPLOYEE BENEFITS 1982

Survey Research Center, Economic Policy Division
Chamber of Commerce of the United States
1615 H Street, N.W., Washington, D.C. 20062

U.S. CHAMBER
SURVEY RESEARCH CENTER

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1. INTRODUCTION

Employee benefit growth during recent years has substantially improved worker well-being, and has also increased the cost of doing business.

Payments for vacations, holidays, rest periods, etc., constitute almost one-third of total employee benefits. These payments are included in most government wage reports as a portion of employee wages. Such payments give employees increased compensation for each hour actually on the job. Thus, they also increase the employer's cost for each hour of productive labor.

Pension, insurance, Social Security, and other employer payments for nonwage employee benefits are not part of the payroll, and are not reflected in current income or wages of employees. Such benefits, however, greatly improve employee security and well-being, and also increase the cost of doing business.

This study is, in general, limited to employees who are not exempt from the Fair Labor Standards Act. Pay of workers covered by this survey varies with the number of hours worked. However, for banks, financial institutions, etc., all nonsupervisory employees and working supervisors are included, regardless of their method of wage payment.

Thirty-five years ago, the Chamber of Commerce of the United States noted the scarcity of statistical information regarding the scope and nature of employee benefits, and conducted the first comprehensive employee benefit study for a cross section of American industry. This study was widely and favorably received. At the request of employers it was repeated biennially with extended coverage and in greater detail.

Responding to numerous requests of employers for more frequent data, we are now conducting annual surveys.

This twenty-first study was possible only with the cooperation of the 1,507 reporting employers who sorted through their records to furnish the detailed information requested, frequently at considerable cost to themselves. We wish to thank them for their help.

Several organizations cooperated with the U.S. Chamber in this study. The Hospital Association of New York State, Kansas City Area Hospital Association, a group of Baltimore hospitials, and the American Paper Institute sent copies of the Questionnaire to some of their members. We greatly appreciate the assistance of these organizations in helping us improve the coverage of this survey.

This survey was conducted in the U.S. Chamber's Survey Research Center, Economic Policy Division, by Judy P. M. Lu and James R. Morris.

RICHARD W. RAHN
Vice President and
Chief Economist

February 1984

2. SUMMARY OF FINDINGS

The survey is generally limited to *hourly rated employees*, whose pay varies with the number of hours worked, except for banks, financial institutions, etc. (See item 2 in the instructions for the questionnaire, on page 32.)

Following are some of the principal findings from the study.

1. Employee benefit payments varied widely among the 1,507 reporting companies, ranging from less than 18 percent to more than 65 percent of payroll and from under $3,000 to more than $11,000 yearly per employee (Table 1).
2. The average payment in 1982 was 36.7 percent of payroll, $3.52 per payroll hour, and $7,187 per year per employee (Table 2).
3. Industry payments varied widely. Wholesale and retail trade (other than department stores) averaged 28.1 percent while primary metal industries paid 47.5 percent (Table 6).
4. Highest payments were made in the East North Central states, followed by the Northeastern states, Western states, and the Southeastern states (Table 9).
5. The largest firms paid higher benefits than smaller firms (Table 10).
6. Payments for nongovernment pensions were reported by 83 percent of the companies (Table 15), with pension payments for these firms averaging 6.0 percent of payroll (Table 16).
7. All but 21 companies reported payments for employee insurance programs, with these insurance payments averaging 6.7 percent of payroll (Table 12).
8. Payrolls of reporting companies included 94.0 percent for straight-time pay, 2.9 percent for overtime premium pay, 0.7 percent for holiday premium pay, 0.5 percent for shift differential, 1.0 percent for earned incentive or production bonus *(4.8 percent for companies making profit-sharing payments*—Table 16), and 0.9 percent for other payroll items (Table 18).
9. Employee payroll deductions for benefits included 6.5 percent for Old-Age, Survivors, Disability, and Health Insurance (FICA taxes); 0.1 percent for Railroad Retirement and state sickness benefits insurance taxes; 0.4 percent for pensions; and 1.5 percent for life, hospitalization, surgical, and other insurance (Table 17).

3. DISTRIBUTION OF BENEFIT PAYMENTS

Payments for employee benefits varied widely among the 1,507 reporting companies. At one extreme were 61 companies paying less than 18 percent of payroll for benefits, while 30 firms paid 65 percent or more.

Expressed as cents per payroll hour, the range was even more extreme. Seventy-two firms paid less than $1.40 an hour, while 93 firms paid $6.00 or more. On an annual basis, 96 firms paid less than $3,000 per employee, and 164 firms paid $11,000 or more.

The distribution of benefit payments for the 1,507 companies is shown in Table 1.

One-tenth of the firms paid more than 49.5 percent of payroll for benefits, while one-fourth paid more than 42.3 percent, as shown in Table 2. Half the firms paid more than 35.5 percent, three-fourths paid more than 28.8 percent, and nine-tenths more than 22.8 percent. The arithmetic mean or average payment was 36.7 percent. This was somewhat larger than the middle payment of 35.5 percent, since it was influenced by the high-paying companies.

Corresponding data as cents per payroll hour and as annual dollars per employee are also shown in Table 2.

Within individual industries, benefit payments also varied widely. Payments in the food, beverages, and tobacco industry varied from under 18 percent to more than 65 percent, a range that was found in several industries. In chemicals and allied products they varied from under 28 percent to more than 65 percent. The distribution of individual company payments by industry groups is shown in Table 3.

TABLE 1. Distribution of Employee Benefits, 1982

Percent of payroll		Cents per payroll hour		Dollars per year per employee	
Percent	Number of companies	Cents	Number of companies	Dollars	Number of companies
Under 18.0%	61	Under 140.0¢	72	Under $3,000	96
18.0-19.9	36	140.0-149.9	23	3,000-3,199	30
20.0-21.9	36	150.0-174.9	76	3,200-3,399	31
22.0-23.9	56	175.0-199.9	91	3,400-3,599	22
24.0-25.9	49	200.0-224.9	77	3,600-3,799	38
26.0-27.9	92	225.0-249.9	104	3,800-3,999	30
28.0-29.9	101	250.0-274.9	103	4,000-4,499	77
30.0-31.9	118	275.0-299.9	115	4,500-4,999	105
32.0-33.9	112	300.0-324.9	104	5,000-5,499	95
34.0-35.9	123	325.0-349.9	95	5,500-5,999	104
36.0-37.9	134	350.0-374.9	89	6,000-6,499	106
38.0-39.9	106	375.0-399.9	80	6,500-6,999	96
40.0-41.9	91	400.0-424.9	85	7,000-7,499	93
42.0-43.9	90	425.0-449.9	69	7,500-7,999	92
44.0-45.9	58	450.0-474.9	66	8,000-8,499	83
46.0-47.9	51	475.0-499.9	47	8,500-8,999	59
48.0-49.9	47	500.0-524.9	33	9,000-9,499	48
50.0-54.9	58	525.0-549.9	36	9,500-9,999	59
55.0-59.9	33	550.0-574.9	23	10,000-10,499	43
60.0-64.9	25	575.0-599.9	26	10,500-10,999	36
65.0 and over	30	600.0 and over	93	11,000 and over	164
TOTAL	1,507	TOTAL	1,507	TOTAL	1,507

TABLE 2. Five Levels of Employee Benefits, 1982

Item	As percent of payroll	Cents per payroll hour	Dollars per year per employee
10% of firms paid more than	49.5%	541.3¢	$11,098
25% of firms paid more than	42.3	429.8	8,760
50% of firms paid more than	35.5	322.3	6,593
75% of firms paid more than	28.8	232.7	4,795
90% of firms paid more than	22.8	166.0	3,366
Mean or average payment	36.7%	352.3¢	$ 7,187

TABLE 3. Distribution of Employee Benefits as Percent of Payroll, by Industry Groups, 1982

Total employee benefits as percent of payroll	Total, all industries	Manufacturing industries															Nonmanufacturing industries							
		Total, all manufacturing	Food, beverages, and tobacco	Textile products and apparel	Pulp, paper, lumber, and furniture	Printing and publishing	Chemicals and allied products	Petroleum industry	Rubber, leather, and plastic products	Stone, clay, and glass products	Primary metal industries	Fabricated metal products (excluding mach. and trans. equipment)	Machinery (excluding electrical)	Electrical machinery, equipment, and supplies	Transportation equipment	Instruments and miscellaneous manufacturing industries	Total, all nonmanufacturing	Public utilities (electric, gas, water, telephone, etc.)	Department stores	Trade (wholesale and other retail)	Banks, finance companies, and trust companies	Insurance companies	Hospitals	Miscellaneous nonmanufacturing industries*
Under 18.0%	61	16	1	4	...	1	...	...	1	...	...	...	3	3	1	2	45	2	1	12	3	2	6	19
18.0-19.9	36	12	...	4	1	...	...	...	...	...	2	1	1	1	...	2	24	...	...	4	5	...	5	10
20.0-21.9	36	11	...	1	...	...	...	1	...	...	...	2	3	2	1	1	25	...	...	3	5	3	6	8
22.0-23.9	56	22	1	1	2	1	...	1	...	...	1	4	2	3	3	3	34	...	...	5	5	3	9	12
24.0-25.9	49	21	2	2	2	2	...	...	...	...	...	3	3	1	3	3	28	1	...	4	7	2	4	10
26.0-27.9	92	29	3	5	2	2	1	...	2	1	1	...	1	6	1	4	63	2	2	7	10	2	21	19
28.0-29.9	101	37	5	5	2	5	...	...	1	...	1	2	8	5	1	2	64	10	3	1	12	9	17	12
30.0-31.9	118	48	2	1	4	3	5	...	4	1	5	4	6	7	2	4	70	3	...	8	14	3	23	19
32.0-33.9	112	50	4	2	2	6	3	...	3	2	...	2	12	4	4	6	62	9	2	4	6	13	17	11
34.0-35.9	123	54	...	4	4	4	3	1	2	...	1	6	9	11	3	6	69	11	...	3	10	17	14	14
36.0-37.9	134	59	7	2	4	3	4	...	2	2	2	4	12	12	3	2	75	15	...	3	11	14	10	22
38.0-39.9	106	48	5	1	3	3	2	...	...	...	5	3	9	8	7	2	58	16	1	3	8	10	4	16
40.0-41.9	91	42	3	1	3	2	3	3	1	...	2	5	6	7	4	2	49	15	...	1	10	14	3	6
42.0-43.9	90	41	1	...	3	3	2	...	4	2	3	7	3	5	4	4	49	21	...	1	10	10	3	4
44.0-45.9	58	39	2	2	3	2	1	2	1	2	3	7	8	3	2	1	19	13	...	...	1	2	1	2
46.0-47.9	51	26	1	...	...	1	3	2	3	2	2	3	1	3	2	3	25	6	...	...	8	2	2	7
48.0-49.9	47	31	...	1	3	...	6	4	1	...	2	5	4	3	1	1	16	11	...	...	1	3	...	1
50.0-54.9	58	39	4	...	2	1	4	2	1	...	6	4	9	2	2	2	19	8	...	2	5	1	...	3
55.0-59.9	33	23	2	1	...	1	2	...	2	2	3	3	3	4	...	...	10	5	...	...	2	1	2	...
60.0-64.9	25	17	1	1	...	...	2	1	1	...	3	3	3	2	...	...	8	2	...	...	4	...	...	2
65.0 and over	30	23	1	...	1	1	2	...	...	...	5	5	4	1	3	...	7	1	...	1	1	1	1	2
Total companies	1,507	688	45	38	41	41	43	17	29	14	47	73	110	93	47	50	819	151	9	62	138	112	148	199
50% of companies paid more than	35.5	37.4	36.7	28.2	36.0	34.4	42.1	47.2	37.9	43.8	44.1	42.6	37.1	36.4	38.2	33.6	33.8	41.2	29.3	26.6	34.7	36.3	30.4	31.3

**Includes research, engineering, education, government agencies, construction, etc.*

4. AVERAGE BENEFIT PAYMENTS

Employee benefit payments in 1982 averaged 36.7 percent of payroll for all companies. Included were:

Legally required payments (employer's share only)	9.5%
Pension, insurance, and other agreed-upon payments (employer's share only)	13.1%
Paid rest periods, lunch periods, etc.	2.8%
Payments for vacations, holidays, sick leave, etc.	9.1%
Profit-sharing payments, bonuses, etc.	2.2%
Total	36.7%

As shown in Table 4, the manufacturing companies averaged 39.1 percent, somewhat more than the all-company average, while the nonmanufacturing companies averaged 34.6 percent.

Manufacturing firms had higher benefit payments for Old-Age, Survivors, Disability, and Health Insurance (FICA taxes), Unemployment Compensation, workers' compensation, life and health insurance premiums, vacations, and paid holidays.

Nonmanufacturing firms had higher payments for non-government pensions, sick leave, employee meals furnished free, and discounts on goods and services purchased from the company.

TABLE 4. Employee Benefits, by Type of Benefit, 1982

Type of benefit	Total, all companies	Total, all manufacturing	Total, all nonmanufacturing
Total employee benefits as percent of payroll	36.7	39.1	34.6
1. Legally required payments (employer's share only)	9.5	10.6	8.6
a. Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	6.6	6.7	6.5
b. Unemployment Compensation	1.4	1.8	1.2
c. Workers' compensation (including estimated cost of self-insured)	1.4	2.1	0.8
d. Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, state sickness benefits insurance, etc.**	0.1	0.1	0.1
2. Pension, insurance, and other agreed-upon payments (employer's share only)	13.1	13.9	12.4
a. Pension plan premiums and pension payments not covered by insurance-type plan (net)	5.0	4.6	5.3
b. Life insurance premiums; death benefits; hospital, surgical, medical, and major medical insurance premiums, etc. (net)	6.6	7.8	5.5
c. Short-term disability	0.3	0.5	0.2
d. Salary continuation or long-term disability	0.3	0.2	0.4
e. Dental insurance premiums	0.4	0.5	0.4
f. Discounts on goods and services purchased from company by employees	0.1	*	0.2
g. Employee meals furnished by company	0.1	*	0.2
h. Miscellaneous payments (vision care, prescription drugs, separation or termination pay, moving expenses, etc.)	0.3	0.2	0.3
3. Paid rest periods, lunch periods, wash-up time, travel time, clothes-change time, get-ready time, etc.	2.8	3.0	2.6
4. Payments for time not worked	9.1	9.2	8.9
a. Paid vacations and payments in lieu of vacation	4.6	5.0	4.2
b. Payments for holidays not worked	2.8	3.1	2.6
c. Paid sick leave	1.2	0.8	1.6
d. Payments for State or National Guard duty; jury, witness, and voting pay allowances; payments for time lost due to death in family or other personal reasons, etc.	0.4	0.3	0.5
5. Other items	2.2	2.3	2.2
a. Profit-sharing payments	1.1	1.3	0.9
b. Contributions to employee thrift plans	0.4	0.3	0.5
c. Christmas or other special bonuses, service awards, suggestion awards, etc.	0.3	0.4	0.3
d. Employee education expenditures (tuition refunds, etc.)	0.2	0.1	0.3
e. Special wage payments ordered by courts, payments to union stewards, etc.	0.2	0.2	0.2
Total employee benefits as cents per payroll hour	352.3	381.0	328.2
Total employee benefits as dollars per year per employee	7,187	7,771	6,697

**Less than 0.05%*

***Figure shown is considerably less than legal rate, because most reporting companies had only a small proportion of employees covered by tax*

5. INDUSTRY VARIATIONS

Employee benefit payments varied widely from industry to industry. The primary metal industries paid 47.5 percent, followed by the chemical and allied products industry paying 44.3 percent, and the petroleum industry paying 44.1 percent. Department stores paid 29.2 percent, and trade (wholesale and other retail) paid 28.1 percent. Hospitals paid 30.7 percent.

Expressed as cents per payroll hour, payments were 590.2 cents for the petroleum industry and 184.7 cents for textile products and apparel. Annual dollars per year per employee were $12,321 for the petroleum industry and $3,584 for textile products and apparel.

Additional summary data on benefit payments by industries are shown in Table 5 and Chart 1.

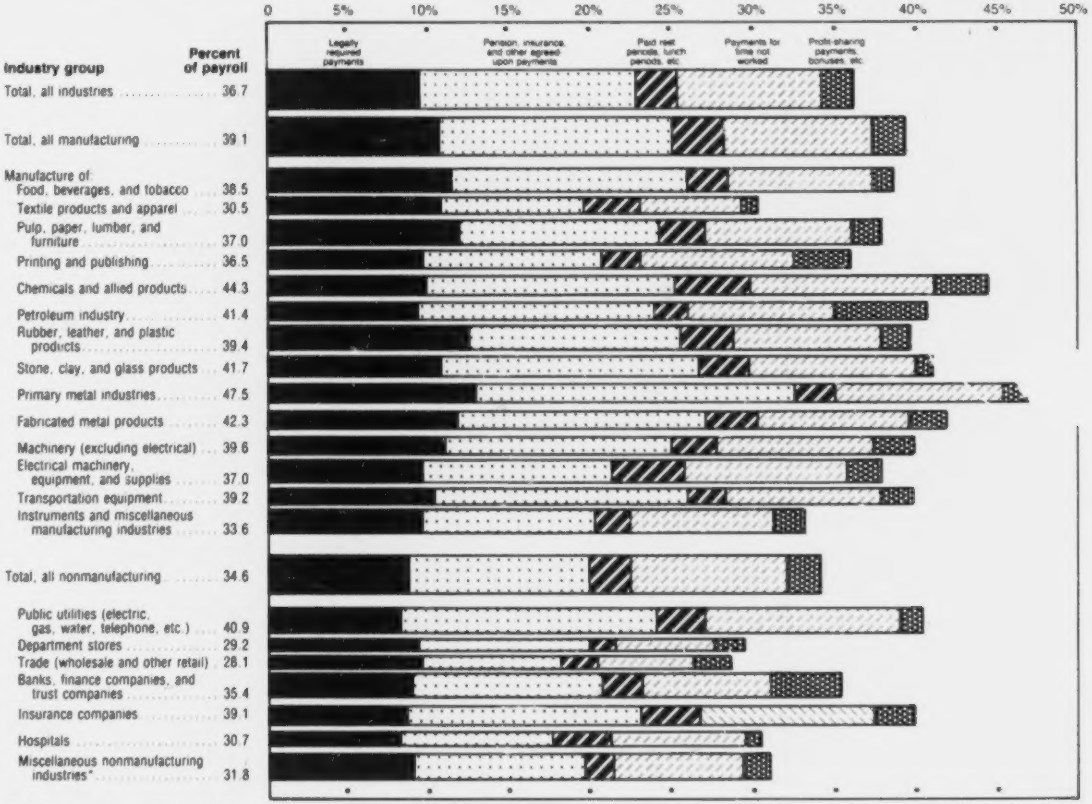
More complete details regarding benefits as percent of payroll, cents per payroll hour, and annual dollars per employee are shown in Tables 6, 7, and 8.

TABLE 5. Major Types of Employee Benefits, by Industry Groups, 1982

	Employee benefits as percent of payroll								
Industry group	Total, all employee benefits	Legally required payments (employer's share only)	Pensions, insurance, and other agreed-upon payments (employer's share only)	Paid rest periods, lunch periods, etc.	Payment for time not worked	Profit-sharing payments, bonuses, etc.	Total employee benefits as cents per payroll hour	Total employee benefits as dollars per year per employee	Number of companies
Total, all industries	36.7	9.5	13.1	2.8	9.1	2.2	352.3	7,187	1,507
Total, all manufacturing	39.1	10.6	13.9	3.0	9.2	2.3	381.0	7,771	688
Manufacture of:									
Food, beverages, and tobacco	38.5	11.1	13.9	2.8	9.2	1.4	356.0	7,442	45
Textile products and apparel	30.5	10.7	8.9	3.4	5.7	1.8	184.7	3,584	38
Pulp, paper, lumber, and furniture	37.0	11.5	12.0	2.9	8.7	1.9	338.0	7,140	41
Printing and publishing	36.5	9.6	11.5	2.4	9.5	3.5	361.0	7,216	41
Chemicals and allied products	44.3	9.8	15.8	4.1	11.2	3.4	459.4	9,551	43
Petroleum industry	44.1	9.3	16.3	2.9	9.5	6.0	590.2	12,320	17
Rubber, leather, and plastic products	39.4	12.4	13.2	3.4	8.5	1.9	342.8	6,920	29
Stone, clay, and glass products	41.7	10.7	16.6	3.7	10.0	0.8	445.5	8,909	14
Primary metal industries	47.5	12.6	20.0	2.5	10.7	1.7	491.8	9,832	47
Fabricated metal products (excluding machinery and transportation equipment)	42.3	11.3	15.7	3.5	9.4	2.4	379.6	7,760	73
Machinery (excluding electrical)	39.6	10.8	14.6	2.5	9.3	2.3	438.4	8,848	110
Electrical machinery, equipment, and supplies	37.0	9.4	12.3	3.7	9.3	2.4	331.0	6,797	93
Transportation equipment	39.2	10.4	15.4	2.1	9.7	1.5	425.3	8,647	47
Instruments and miscellaneous manufacturing industries	33.6	9.4	10.7	2.8	8.4	2.4	292.9	6,018	50
Total, all nonmanufacturing	34.6	8.6	12.4	2.6	8.9	2.2	328.2	6,697	819
Public utilities (electric, gas, water, telephone, etc.)	40.9	8.1	16.9	2.8	11.7	1.5	461.6	9,653	151
Department Stores	29.2	9.3	10.2	1.6	6.3	1.9	173.9	3,419	9
Trade (wholesale and other retail)	28.1	9.4	8.7	2.2	5.2	2.7	231.5	4,706	62
Banks, finance companies, and trust companies	35.4	8.9	12.4	2.4	7.5	4.3	283.2	5,744	138
Insurance companies	39.1	8.3	14.9	3.2	10.0	2.7	327.1	6,487	112
Hospitals	30.7	8.1	9.8	3.1	9.1	0.6	255.8	5,305	148
Miscellaneous nonmanufacturing industries*	31.8	9.0	10.6	1.9	8.3	2.0	349.8	7,038	199

Includes research, engineering, education, government agencies, construction, etc.

CHART 1. Employee Benefits as Percent of Payroll, by Industry Groups, 1,507 Companies, 1982



*Includes research, engineering, education, government agencies, construction, etc.

TABLE 6. Employee Benefits as Percent of Payroll, by Type of Benefit and Industry Groups, 1982

Type of benefit	Total, all industries	Manufacturing industries: Total, all manufacturing	Food, beverages, and tobacco	Textile products and apparel	Pulp, paper, lumber, and furniture	Printing and publishing	Chemicals and allied products	Petroleum industry	Rubber, leather, and plastic products	Stone, clay, and glass products	Primary metal industries	Fabricated metal products (excluding mach. and trans. equipment)	Machinery (excluding electrical)	Electrical machinery, equipment, and supplies	Transportation equipment	Instruments and miscellaneous manufacturing industries	Nonmanufacturing industries: Total, all nonmanufacturing	Public utilities (electric, gas, water, telephone, etc.)	Department stores	Trade (wholesale and other retail)	Banks, finance companies, and trust companies	Insurance companies	Hospitals	Miscellaneous nonmanufacturing industries*
Total employee benefits as percent of payroll	36.7	39.1	38.5	30.5	37.0	36.5	44.3	44.1	38.4	41.7	47.5	42.3	38.6	37.0	38.2	33.6	34.6	40.9	29.2	28.1	35.4	38.1	30.7	31.8
1. Legally required payments (employer's share only)	9.5	10.6	11.1	10.7	11.5	9.6	9.8	9.3	12.4	10.7	12.6	11.3	10.8	9.4	10.4	9.4	8.6	8.1	9.3	9.4	8.9	8.3	8.1	9.0
a. Old-Age, Survivors, Disability and Health Insurance (FICA taxes)	6.6	6.7	6.7	6.7	6.7	6.5	6.7	6.5	6.7	6.9	7.0	6.8	6.6	6.6	6.6	6.5	6.5	6.5	6.4	6.4	6.4	7.0	6.6	6.2
b. Unemployment Compensation	1.4	1.8	1.7	2.3	1.6	2.1	1.0	0.7	1.9	2.3	2.0	1.7	2.0	1.5	1.9	1.6	1.2	0.7	1.4	1.5	2.1	1.0	0.6	1.4
c. Workers' compensation (including estimated cost of self-insured)	1.4	2.1	2.6	1.7	3.0	0.9	2.0	2.0	3.8	1.5	3.5	2.8	2.2	1.1	1.9	1.2	0.8	0.9	1.4	1.3	0.3	0.3	0.8	1.1
d. Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, state sickness benefits insurance, etc.**	0.1	0.1	0.1	***	0.3	0.1	***	***	***	***	***	***	***	0.2	***	0.1	0.1	***	***	***	0.1	***	0.2	0.4
2. Pension, insurance, and other agreed-upon payments (employer's share only)	13.1	13.9	13.9	8.9	12.0	11.5	15.8	16.3	13.2	16.6	20.0	15.7	14.6	12.3	15.4	10.7	12.4	16.9	10.2	8.7	12.4	14.9	9.9	10.6
a. Pension plan premiums and pension payments not covered by insurance-type plan (net)	5.0	4.6	5.1	2.2	3.7	4.3	6.9	8.1	3.5	6.1	7.3	5.4	4.5	3.5	4.9	2.9	5.3	9.2	3.3	2.3	5.0	6.4	3.4	4.5
b. Life insurance premiums, death benefits, hospital, surgical, medical, and major medical insurance premiums, etc. (net)	6.6	7.8	7.0	5.7	6.9	6.0	7.1	6.7	8.4	8.6	10.8	9.1	8.8	7.4	8.6	6.6	5.5	6.2	3.5	4.9	5.4	6.5	5.0	5.1
c. Short-term disability	0.3	0.5	0.5	0.3	0.5	0.2	0.6	0.3	0.4	0.4	0.8	0.5	0.5	0.3	0.8	0.4	0.2	0.2	0.2	0.2	0.2	0.4	0.2	0.1
d. Salary continuation or long-term disability	0.3	0.2	0.2	0.1	0.2	0.2	0.3	0.3	0.2	0.3	0.1	0.1	0.2	0.2	0.1	0.2	0.4	0.3	***	0.2	0.9	0.3	0.2	0.3
e. Dental insurance premiums	0.4	0.5	0.5	0.1	0.3	0.3	0.6	0.5	0.2	0.4	0.6	0.5	0.5	0.6	0.7	0.4	0.4	0.4	0.1	0.3	0.4	0.3	0.4	0.3
f. Discounts on goods and services purchased from company by employees	0.1	***	***	0.4	***	***	***	0.1	***	***	***	***	***	***	***	***	0.2	0.1	3.0	0.7	0.1	***	0.2	***
g. Employee meals furnished by company	0.1	***	***	***	***	0.1	0.2	0.3	***	***	***	***	***	0.1	***	***	0.2	0.1	***	0.1	0.3	0.5	0.1	0.1
h. Miscellaneous payments (vision care, prescription drugs, separation or termination pay, moving expenses, etc.)	0.3	0.2	0.6	0.1	0.3	0.3	0.2	0.1	0.5	0.9	0.3	0.2	0.2	0.2	0.2	0.1	0.3	0.3	***	0.1	0.2	0.5	0.3	0.2
3. Paid rest periods, lunch periods, wash-up time, travel time, clothes-change time, get-ready time, etc.	2.8	3.0	2.8	3.4	2.9	2.4	4.1	2.9	3.4	3.7	2.5	3.5	2.5	3.7	2.1	2.8	2.6	2.8	1.6	2.2	2.4	3.2	3.1	1.9
4. Payments for time not worked	9.1	9.2	9.2	5.7	8.7	9.5	11.2	9.5	8.5	10.0	10.7	9.4	9.3	9.3	9.7	8.4	8.9	11.7	6.3	5.2	7.5	10.0	9.1	8.3
a. Paid vacations and payments in lieu of vacation	4.6	5.0	5.2	3.2	5.1	4.9	5.7	4.8	5.1	6.1	6.8	5.4	5.2	4.6	5.1	4.0	4.2	5.4	3.4	2.9	3.2	4.6	4.6	3.8
b. Payments for holidays not worked	2.8	3.1	3.0	2.2	2.9	2.8	3.5	2.7	2.7	2.7	3.1	3.5	3.3	3.3	3.3	2.9	2.6	3.4	1.9	1.5	2.4	3.3	2.1	2.6
c. Paid sick leave	1.2	0.8	0.8	0.2	0.3	1.3	1.5	1.6	0.3	0.6	0.3	0.3	0.6	1.1	1.0	1.1	1.6	2.0	0.8	0.7	1.4	1.6	2.0	1.8
d. Payments for State or National Guard duty, jury, witness, and voting pay allowances; payments for time lost due to death in family or other personal reasons, etc.	0.4	0.3	0.2	0.1	0.4	0.5	0.5	0.4	0.3	0.6	0.6	0.2	0.3	0.4	0.4	0.4	0.5	0.8	0.1	0.1	0.5	0.5	0.5	0.3
5. Other items	2.2	2.3	1.4	1.8	1.9	3.5	3.4	6.0	1.9	0.8	1.7	2.4	2.3	2.4	1.5	2.4	2.2	1.5	1.9	2.7	4.3	2.7	0.6	2.0
a. Profit-sharing payments	1.1	1.3	0.7	1.2	1.2	2.2	1.3	3.2	1.4	0.5	0.8	1.1	1.5	1.3	0.6	1.3	0.9	0.1	1.7	2.2	2.2	0.9	0.1	0.9
b. Contributions to employee thrift plans	0.4	0.3	0.2	0.1	***	0.5	1.1	1.9	***	***	0.3	0.2	0.2	0.2	0.3	0.3	0.5	0.7	0.1	0.1	0.9	0.7	—	0.3
c. Christmas or other special bonuses, service awards, suggestion awards, etc.	0.3	0.4	0.4	0.4	0.6	0.6	0.7	0.6	0.3	0.1	0.4	0.6	0.2	0.5	0.2	0.4	0.3	0.1	0.1	0.3	0.5	0.4	0.1	0.3
d. Employee education expenditures (tuition refunds, etc.)	0.2	0.1	***	0.1	***	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.1	0.3	0.3	0.2	***	0.1	0.5	0.4	0.3	0.3
e. Special wage payments ordered by courts, payments to union stewards, etc.	0.2	0.2	0.1	0.1	***	0.1	0.2	0.2	0.1	0.1	0.2	0.4	0.3	0.1	0.3	0.1	0.2	0.4	***	***	0.1	0.3	0.1	0.2

*Includes research, engineering, education, government agencies, construction, etc.

**Figure is considerably less than legal rate, because most reporting companies had only a small proportion of employees covered by tax.

***Less than 0.05%.

TABLE 7. Employee Benefits as Cents per Payroll Hour, by Type of Benefit and Industry Groups, 1982

		Manufacturing industries															Nonmanufacturing industries							
Type of benefit	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total employee benefits as cents per payroll hour	352.3	361.0	366.0	184.7	338.0	261.0	458.4	590.2	342.8	445.5	491.8	379.6	438.4	331.0	425.3	332.9	328.2	461.6	173.9	231.5	383.2	307.1	255.8	349.6
1. Legally required payments (employer's share only)	89.7	100.2	98.6	64.7	98.5	97.9	101.5	119.7	104.6	111.5	122.3	101.9	118.1	82.1	109.0	80.9	80.9	90.2	53.0	74.2	72.8	70.6	67.6	98.5
a. Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	62.4	64.1	60.6	40.3	59.5	68.8	69.4	87.3	56.6	72.0	69.8	61.2	74.2	59.6	69.9	56.8	61.0	72.7	37.3	51.7	52.2	58.7	55.4	67.6
b. Unemployment Compensation	13.4	16.2	15.0	13.9	12.8	21.6	10.2	9.2	15.6	23.1	19.4	15.3	21.7	12.3	19.6	13.6	11.0	7.5	8.2	11.3	17.8	9.0	4.0	15.5
c. Workers' compensation (including estimated cost of self-insured)	12.7	19.2	22.1	10.5	23.6	6.6	21.7	22.9	32.1	16.4	32.7	25.2	21.7	8.9	19.2	10.0	7.2	9.7	7.2	11.0	2.2	2.6	6.9	10.6
d. Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, state sickness benefits insurance, etc.**	1.2	0.7	0.9	0.1	2.6	0.9	0.3	0.2	0.3	***	0.4	0.1	0.5	1.3	0.3	0.5	1.6	0.3	0.3	0.2	0.6	0.3	1.3	4.9
2. Pension, insurance, and other agreed-upon payments (employer's share only)	128.1	139.5	130.9	54.0	114.2	114.7	162.3	219.3	118.9	184.3	216.6	141.3	167.6	110.7	160.7	93.7	110.6	192.0	50.6	74.0	98.3	123.6	81.1	118.5
a. Pension plan premiums and pension payments not covered by insurance-type plan (net)	50.9	48.7	48.7	13.8	37.9	43.5	71.5	112.4	32.4	69.9	84.5	49.0	54.6	32.5	56.6	28.2	52.8	105.1	18.7	21.0	30.3	50.1	39.2	52.7
b. Life insurance premiums, death benefits, hospital, surgical, medical, and major medical insurance premiums, etc. (net)	62.5	75.9	64.4	34.8	63.0	58.8	72.1	85.7	73.2	90.2	111.4	80.0	97.6	66.6	92.0	57.1	51.1	70.2	20.9	40.9	42.7	52.7	41.0	50.6
c. Short-term disability	3.2	4.6	5.2	1.6	4.6	2.4	5.4	3.3	3.2	4.0	8.2	4.9	5.1	3.0	6.5	4.1	2.0	2.6	1.4	1.5	1.8	3.2	1.5	1.6
d. Salary continuation or long-term disability	2.8	1.8	1.4	0.8	1.5	2.1	2.7	4.7	2.2	3.2	1.7	1.0	1.9	1.9	1.2	1.7	3.7	3.7	0.1	1.5	0.0	2.9	2.0	3.4
e. Dental insurance premiums	4.0	4.9	4.7	0.8	3.2	3.8	6.6	6.2	1.9	4.4	7.0	4.6	5.9	5.4	7.7	3.5	3.3	4.3	0.7	2.6	3.0	3.0	3.3	3.2
f. Discounts on goods and services purchased from company by employees	0.8	0.3	0.2	1.7	0.2	0.5	0.1	0.9	0.5	***	***	0.1	0.3	***	0.5	0.2	1.3	1.5	17.9	4.5	0.6	0.3	1.4	0.3
g. Employee meals furnished by company	1.2	0.5	0.3	***	0.5	0.6	1.7	4.0	0.3	0.4	0.1	0.2	0.3	0.6	0.1	0.1	1.7	1.5	0.2	0.6	2.5	4.3	1.1	0.8
h. Miscellaneous payments (vision care, prescription drugs, separation or termination pay, moving expenses, etc.)	2.6	2.6	6.6	0.4	3.1	3.8	2.0	2.1	5.3	12.2	3.7	1.5	1.9	1.8	3.0	0.8	2.6	3.1	***	1.4	1.4	4.1	2.7	2.8
3. Paid rest periods, lunch periods, wash-up time, travel time, clothes-change time, get-ready time, etc.	25.5	27.7	25.8	19.9	23.8	22.0	42.4	38.8	26.4	36.9	22.7	30.1	28.5	31.6	22.2	22.9	23.7	30.3	11.2	17.9	19.6	24.1	27.1	26.9
4. Payments for time not worked	87.2	90.8	88.2	34.3	82.2	97.1	117.1	124.5	75.6	106.0	114.5	85.1	97.3	94.5	108.1	74.1	84.1	132.3	38.3	42.8	59.1	84.0	75.5	86.4
a. Paid vacations and payments in lieu of vacation	44.2	49.8	49.7	18.9	48.7	50.4	59.2	63.7	45.8	68.1	75.0	49.0	54.4	46.9	56.4	35.8	39.5	61.8	21.4	23.2	25.7	39.0	38.3	39.1
b. Payments for holidays not worked	27.1	29.8	28.6	13.4	28.9	29.4	36.8	36.0	23.7	27.0	36.9	31.5	33.9	28.8	37.2	25.2	24.8	38.7	11.4	13.1	15.9	27.8	17.6	28.8
c. Paid sick leave	11.9	7.6	8.1	1.2	2.7	12.6	15.7	21.2	2.7	4.2	2.8	3.2	6.1	10.6	11.2	9.8	15.5	22.9	4.9	5.6	11.0	13.4	16.3	17.6
d. Payments for State or National Guard duty, jury, witness, and voting pay allowances, payments for time lost due to death in family or other personal reasons, etc.	4.0	3.5	1.9	0.9	3.8	4.8	5.4	4.6	3.4	6.7	5.8	1.4	2.9	4.2	4.2	3.4	4.4	8.9	0.6	0.9	3.5	3.9	3.8	3.6
5. Other items	21.8	22.9	12.5	11.7	19.3	29.2	36.2	87.9	17.3	6.9	15.6	21.3	28.9	22.1	15.3	21.3	20.9	16.7	11.5	22.6	33.4	24.7	4.5	25.5
a. Profit-sharing payments	10.7	12.3	5.7	7.7	12.4	14.5	13.7	48.7	12.6	4.3	7.2	9.9	17.8	12.0	5.2	12.2	9.4	0.9	10.6	18.2	18.0	9.1	0.4	14.0
b. Contributions to employee thrift plans	3.9	3.1	2.0	0.8	0.4	4.6	10.8	25.8	0.1	0.1	2.7	1.4	1.7	2.8	3.8	2.4	4.5	8.0	0.4	0.9	6.2	6.6	0.3	4.1
c. Christmas or other special bonuses, service awards, suggestion awards, etc.	3.1	4.1	3.0	2.2	5.7	6.8	8.5	9.3	2.4	1.1	3.1	5.7	2.4	4.4	1.4	3.1	2.2	1.3	0.4	2.2	4.0	3.0	0.8	2.4
d. Employee education expenditures (tuition refunds, etc.)	2.3	1.3	0.4	0.4	0.4	2.2	1.0	1.9	0.8	0.6	0.5	0.9	1.4	2.4	1.3	2.6	3.0	2.3	0.1	1.0	4.4	3.4	2.5	3.5
e. Special wage payments ordered by courts, payments to union stewards, etc.	1.9	2.1	1.6	0.6	0.4	1.2	2.1	3.2	1.5	0.9	2.1	3.3	3.6	1.3	3.8	0.9	1.7	4.1	***	0.4	0.7	2.8	0.5	1.4

*Includes research, engineering, education, government agencies, construction, etc.

**Figure is considerably less than legal rate, because most reporting companies had only a small proportion of employees covered by law.

***Less than 0.05¢.

TABLE 8. Employee Benefits as Dollars per Year per Employee, by Type of Benefit and Industry Groups, 1982

Type of benefit	Total, all industries	Manufacturing industries															Nonmanufacturing industries							
		Total, all manufacturing	Food, beverages, and tobacco	Textile products and apparel	Pulp, paper, lumber, and furniture	Printing and publishing	Chemicals and allied products	Petroleum industry	Rubber, leather, and plastic products	Stone, clay, and glass products	Primary metal industries	Fabricated metal products (excluding machinery and transportation equipment)	Machinery (excluding electrical)	Electrical machinery, equipment, and supplies	Transportation equipment	Instruments and miscellaneous manufacturing industries	Total, all nonmanufacturing	Public utilities (electric, gas, water, telephone, etc.)	Department stores	Trade (wholesale and other retail)	Banks, finance, and trust companies	Insurance companies	Hospitals	Miscellaneous nonmanufacturing industries*
Total employee benefits as dollars per year per employee	7 187	7 771	7 442	3 584	7 140	7 216	9 551	12 321	6 920	8 909	9 832	7 760	8 848	6 797	8 647	6 018	6 697	9 653	3 419	4 706	6 714	6 487	5 306	7 038
1. Legally required payments (employer's share only)	1 825	2 041	2 065	1 251	2 047	1 962	2 103	2 496	2 115	2 228	2 450	2 070	2 388	1 689	2 232	1 656	1 644	1 886	1 046	1 521	1 480	1 400	1 402	1 955
a. Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	1 274	1 309	1 271	784	1 253	1 332	1 447	1 821	1 149	1 439	1 398	1 251	1 495	1 226	1 434	1 168	1 244	1 522	735	1 058	1 060	1 166	1 150	1 357
b. Unemployment Compensation	269	329	307	260	256	437	210	193	315	472	390	313	446	252	399	276	219	156	162	230	364	178	83	290
c. Workers' compensation (including estimated cost of self-insured)	258	389	468	206	484	176	440	477	645	318	655	504	437	181	393	204	148	202	145	229	44	51	142	215
d. Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, state sickness benefits insurance, etc.**	24	14	20	1	54	17	6	4	7	***	8	3	9	30	6	9	32	6	5	5	13	5	27	94
2. Pension, insurance, and other agreed-upon payments (employer's share only)	2 614	2 840	2 722	1 053	2 417	2 297	3 370	4 590	2 415	3 691	4 327	2 892	3 377	2 267	3 418	1 923	2 424	4 017	1 181	1 500	1 995	2 452	1 680	2 394
a. Pension plan premiums and pension payments not covered by insurance-type plan (net)	1 040	991	1 009	273	813	870	1 487	2 358	654	1 391	1 689	994	1 098	666	1 128	536	1 081	2 198	375	424	777	1 053	584	1 066
b. Life insurance premiums, death benefits, hospital, surgical, medical, and major medical insurance premiums, etc. (net)	1 274	1 548	1 344	680	1 327	1 183	1 497	1 792	1 488	1 831	2 226	1 642	1 968	1 341	1 872	1 177	1 044	1 468	414	831	865	1 045	850	1 086
c. Short-term disability	65	94	107	30	103	47	112	69	65	81	159	101	101	61	168	81	41	53	28	32	36	64	31	32
d. Salary continuation or long-term disability	58	37	29	16	30	40	56	95	45	66	35	21	39	39	25	36	74	78	2	30	166	57	41	87
e. Dental insurance premiums	83	101	97	16	70	76	136	130	39	87	141	97	120	112	155	72	67	90	14	52	60	61	68	65
f. Discounts on goods and services purchased from company by employees	17	6	4	30	4	10	3	18	9	***	***	1	6	***	10	4	26	32	344	93	12	7	30	6
g. Employee meals furnished by company	24	11	7	1	12	11	37	84	6	8	2	5	7	12	3	2	35	32	3	12	51	83	22	15
h. Miscellaneous payments (vision care, prescription drugs, separation or termination pay, moving expenses, etc.)	53	53	125	8	57	59	43	43	154	227	74	32	37	38	59	15	54	66	***	28	29	81	55	58
3. Paid rest periods, lunch periods, wash-up time, travel time, clothes-change time, get-ready time, etc.	523	566	551	392	496	441	882	815	525	741	456	615	574	646	461	477	485	636	219	366	398	479	563	424
4. Payments for time not worked	1 782	1 852	1 839	665	1 772	1 921	2 435	2 604	1 521	2 109	2 283	1 746	1 954	1 740	2 229	1 521	1 723	2 766	754	874	1 199	1 662	1 566	1 754
a. Paid vacations and payments in lieu of vacation	902	1 014	1 037	365	1 052	997	1 231	1 335	922	1 364	1 488	1 004	1 190	840	1 144	733	808	1 292	421	471	521	772	794	793
b. Payments for holidays not worked	553	608	595	258	572	577	763	731	473	536	613	646	582	592	764	518	508	809	222	269	383	549	354	544
c. Paid sick leave	244	158	175	24	59	249	329	444	55	88	58	67	123	222	236	201	317	479	98	115	223	266	330	345
d. Payments for State or National Guard duty, jury, witness, and voting pay allowances, payments for time lost due to death in family or other personal reasons, etc.	82	73	37	18	90	98	112	95	71	122	125	29	59	86	85	70	90	186	13	19	72	75	79	72
5. Other items	444	471	264	222	408	594	762	1 816	349	140	316	438	556	455	307	442	422	349	219	444	673	494	94	510
a. Profit-sharing payments	218	254	121	141	256	300	296	960	254	88	148	201	370	247	104	252	188	18	201	352	360	185	9	278
b. Contributions to employee thrift plans	80	65	40	16	10	53	224	558	3	1	55	33	35	43	75	50	93	168	9	18	128	130	6	84
c. Christmas or other special bonuses, service awards, suggestion awards, etc.	62	83	62	45	115	134	176	192	49	22	63	116	50	90	30	56	45	28	7	46	80	59	17	48
d. Employee education expenditures (tuition refunds, etc.)	46	27	8	8	9	43	22	39	13	10	11	19	28	50	28	55	62	49	1	21	90	68	52	70
e. Special wage payments ordered by courts, payments to union stewards, etc.	38	42	33	13	9	23	45	67	31	19	39	70	74	26	70	19	35	86	1	8	15	52	10	29

*Includes research, engineering, education, government agencies, construction, etc.

**Figure is considerably less than legal rate, because most reporting companies had only a small proportion of employees covered by tax.

***Less than 50¢.

6. REGIONAL VARIATIONS

Benefit payments by region for the various industry groups are shown in Table 9. The regions are based upon United States Bureau of the Census divisions. States constituting each region are listed in a footnote following the table.

For all industries, payments averaged 38.9 percent of payroll in the East North Central region, followed by a 38.4 percent in the Northeast region.

The Western region averaged 34.8 percent, and the Southeast region averaged 34.6 percent.

TABLE 9. Employee Benefits as Percent of Payroll, by Region and Industry Groups, 1982

Industry group	Total, all regions*	Northeast*	East North Central*	Southeast*	West*
Total, all industries	36.7	38.4	38.9	34.6	34.8
Total, all manufacturing	39.1	41.3	41.4	34.8	36.9
Manufacture of:					
Food, beverages, and tobacco	36.5	40.3	41.2	30.0	41.2
Textile products and apparel	30.5	36.6	28.8	27.0	36.1
Pulp, paper, lumber, and furniture	37.0	39.6	36.8	31.5	40.4
Printing and publishing	36.5	32.6	32.7	35.3	41.1
Chemicals and allied products	44.3	43.7	48.9	38.6	47.3
Petroleum industry	44.1	41.5	47.6	43.7	44.1
Rubber, leather, and plastic products	39.4	40.6	42.4	39.7	32.7
Stone, clay, and glass products	41.7	35.1	39.4	...	44.5
Primary metal industries	47.5	52.8	48.7	43.3	29.9
Fabricated metal products (excluding machinery and transportation equipment)	42.3	46.6	43.1	33.8	38.0
Machinery (excluding electrical)	39.6	38.5	41.1	41.7	34.2
Electrical machinery, equipment, and supplies	37.0	42.5	39.1	30.7	33.8
Transportation equipment	39.2	40.2	42.0	38.4	34.4
Instruments and miscellaneous manufacturing industries	33.6	36.2	38.3	27.7	30.4
Total, all nonmanufacturing	34.6	35.3	35.7	34.5	33.4
Public utilities (electric, gas, water, telephone, etc.)	40.9	41.5	41.0	39.1	43.0
Department stores	29.2	31.3	34.3	27.5	26.1
Trade (wholesale and other retail)	28.1	28.3	35.3	24.0	25.8
Banks, finance companies, and trust companies	35.4	34.0	38.8	38.1	31.8
Insurance companies	39.1	35.9	36.2	48.8	36.4
Hospitals	30.7	32.9	32.3	26.9	31.3
Miscellaneous nonmanufacturing industries**	31.8	34.8	31.8	29.8	32.3
Number of companies	1,507	386	367	366	388

*States in each region are:

NORTHEAST: Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, and Vermont.

EAST NORTH CENTRAL: Illinois, Indiana, Michigan, Ohio, and Wisconsin.

SOUTHEAST: Alabama, Arkansas, Delaware, District of Columbia, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia, and West Virginia.

WEST: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Iowa, Kansas, Minnesota, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington, and Wyoming.

**Includes research, engineering, education, government agencies, construction, etc.

7. SIZE OF COMPANY VARIATIONS

The largest firms paid higher benefits than smaller firms, and benefits increased with size of company, except for two categories, as shown in Table 10.

Companies with 5,000 or more employees paid 38.5 percent for benefits. Companies with 2,500 to 4,999 employees paid 36.2 percent, and those with 1,000 to 2,499 averaged 36.3 percent. Companies with 500 to 999 employees averaged 37.2 percent, and those employing 100 to 499 averaged 36.7 percent. Those companies with fewer than 100 employees paid 34.8 percent of payroll for benefits.

TABLE 10. Employee Benefits as Percent of Payroll, by Size of Company and Industry Groups, 1982

Industry group	Total all companies	Number of employees					
		Under 100	100-499	500-999	1,000-2,499	2,500-4,999	5,000 and over
Total, all industries	36.7	34.8	36.7	37.2	36.3	36.2	38.5
Total, all manufacturing	39.1	39.2	39.0	38.1	39.7	38.9	40.4
Manufacture of:							
Food, beverages, and tobacco	38.5	40.3	35.6	40.0	49.3	35.3	37.9
Textile products and apparel	30.5	21.9	35.8	33.4	25.9	19.5	27.6
Pulp, paper, lumber, and furniture	37.0	38.9	36.2	33.4	42.6	50.2	35.0
Printing and publishing	36.5	37.3	34.0	30.8	47.3	30.6	37.7
Chemicals and allied products	44.3	47.6	43.1	48.4	46.0	34.9	44.2
Petroleum industry	44.1	31.5	47.9	48.2	50.5	41.4	35.9
Rubber, leather, and plastic products	39.4	38.4	39.5	33.8	...	42.4	52.8
Stone, clay, and glass products	41.7	38.3	42.5	...	45.3	...	47.3
Primary metal industries	47.5	42.8	48.7	51.6	37.0	55.5	57.8
Fabricated metal products (excluding machinery and transportation equipment)	42.3	41.2	43.4	38.6	49.5	39.5	...
Machinery (excluding electrical)	39.6	42.1	37.6	38.6	37.0	47.6	46.1
Electrical machinery, equipment, and supplies	37.0	33.6	38.6	35.9	38.2	32.2	35.8
Transportation equipment	39.2	37.3	36.8	41.1	36.4	34.4	43.1
Instruments and miscellaneous manufacturing industries	33.6	33.9	33.1	31.1	35.6	...	35.2
Total, all nonmanufacturing	34.6	30.2	33.4	36.4	34.6	35.2	37.2
Public utilities (electric, gas, water, telephone, etc.)	40.9	35.7	41.9	41.2	41.3	40.9	40.2
Department stores	29.2	...	24.9	28.5	...	28.5	32.0
Trade (wholesale and other retail)	28.1	27.3	28.5	21.2	25.6	28.2	31.2
Banks, finance companies, and trust companies	35.4	32.4	36.5	36.6	35.8	31.9	35.9
Insurance companies	39.1	31.8	35.1	50.7	37.8	39.0	35.7
Hospitals	30.7	34.0	33.3	29.9	29.9	30.5	40.4
Miscellaneous nonmanufacturing industries*	31.8	29.9	30.1	32.1	33.4	34.7	38.3
Number of companies	1,507	184	449	245	297	133	199

*Includes research, engineering, education, government agencies, construction, etc.

8. PENSION AND INSURANCE COSTS

Due to the wide interest in private pension and insurance programs, tabulations are included showing distributions of amounts paid by individual companies for these programs, and also average employee payroll deductions for pensions and insurance. Employer payments are net amounts after deducting any dividends or credits returned to the employer by the insurer.

As shown in Table 11, 255 firms, or 17 percent of those

TABLE 11. Pension* Payments, by Industry Groups, 1982

Industry group	Total companies in survey	Number of companies paying specified percent of payroll for pensions									Pension payments as percent of payroll				Average pension payments as percent of payroll for companies having pensions
		0%	0.1-1.9%	2.0-3.9%	4.0-5.9%	6.0-7.9%	8.0-9.9%	10.0-11.9%	12.0-13.9%	14.0% and over	Total	Premiums under insurance and annuity contracts	Payments to uninsured trusteed pension plans	Payments under unfunded pension plans	
Total, all industries	1,507	255	139	313	298	208	112	88	31	63	5.0	3.1	1.7	0.2	6.0
Total, all manufacturing	688	126	78	159	125	86	37	34	9	34	4.6	2.8	1.7	0.1	5.7
Manufacture of:															
Food, beverages, and tobacco	45	7	3	13	6	6	5	2	1	2	5.1	2.9	1.9	0.3	5.9
Textile products and apparel	38	10	10	14	...	2	2	...	...	...	2.3	1.1	1.0	0.2	3.0
Pulp, paper, lumber, and furniture	41	7	8	9	5	9	3	...	...	...	3.7	2.5	1.1	0.1	4.5
Printing and publishing	41	8	3	8	12	4	2	3	1	...	4.3	3.1	1.2	**	5.4
Chemicals and allied products	43	1	4	5	10	9	3	7	1	3	6.9	3.8	3.0	0.1	7.1
Petroleum industry	17	2	...	2	2	3	2	2	...	4	8.1	2.6	4.8	0.7	9.2
Rubber, leather, and plastic products	29	5	3	11	5	2	1	1	1	...	3.5	2.6	0.8	0.1	4.2
Stone, clay, and glass products	14	2	...	...	5	5	1	...	...	1	6.1	2.8	2.9	0.4	7.1
Primary metal industries	47	8	3	7	9	4	3	4	2	7	7.3	4.1	3.2	**	8.8
Fabricated metal products (excluding machinery and transportation equipment)	73	13	6	19	14	4	5	2	1	9	5.4	3.9	1.4	0.1	6.5
Machinery (excluding electrical)	110	19	9	29	19	18	5	8	...	3	4.6	2.9	1.5	0.2	5.4
Electrical machinery, equipment, and supplies	93	25	17	17	17	6	4	2	2	3	3.5	2.1	1.4	**	4.8
Transportation equipment	47	5	7	9	12	9	1	3	...	1	4.9	2.8	2.1	**	5.5
Instruments and miscellaneous manufacturing industries	50	14	5	16	9	5	...	...	...	1	2.9	1.5	1.3	0.1	4.0
Total, all nonmanufacturing	819	129	61	154	173	122	75	54	22	29	5.3	3.4	1.7	0.2	6.3
Public utilities (electric, gas, water, telephone, etc.)	151	3	...	8	21	36	31	27	9	16	9.2	5.4	3.5	0.3	9.4
Department stores	9	2	1	3	2	...	...	1	...	...	3.3	0.4	1.6	1.3	4.2
Trade (wholesale and other retail)	62	24	12	11	8	5	1	...	1	...	2.3	1.5	0.7	0.1	3.7
Banks, finance companies, and trust companies	138	19	6	27	41	23	10	7	1	4	5.0	2.5	2.3	0.2	5.7
Insurance companies	112	6	10	17	30	21	11	8	7	2	6.4	4.9	1.3	0.2	6.7
Hospitals	148	12	22	62	39	9	1	2	...	1	3.3	2.4	0.9	**	3.7
Miscellaneous nonmanufacturing industries***	199	63	10	26	32	28	21	9	4	6	4.4	3.3	0.9	0.2	6.5

**Includes net pension-plan premiums and pension payments not covered by insurance-type plan.*

***Less than 0.05%.*

****Includes research, engineering, education, government agencies, construction, etc.*

surveyed, reported no payments for private pensions, while 63 companies paid amounts for pensions equaling 14 percent or more of payroll. Pension payments for all companies surveyed averaged 5.0 percent of payroll (the figure shown in Tables 4 and 6), but if companies reporting no pension payments are omitted, the average becomes 6.0 percent of payroll.

The average pension payment of 5.0 percent included 3.1 percent for premiums under insurance or annuity contracts, 1.7 percent for payments to uninsured trusteed pension plans, and 0.2 percent for payments under unfunded pension plans.

Among the manufacturing industries 18 percent of the firms reported no pension payments, while among the nonmanufacturing firms 16 percent reported no pension payments. Eleven percent of the manufacturing firms paid 10 percent or more of payroll for pensions, while 13 percent of the nonmanufacturing firms paid 10 percent or more.

The distribution of insurance payments by industry groups is shown in Table 12. Payments for insurance were reported by all but 21of the firms. The most frequent amount paid for insurance was 4.0 to 5.9 percent of payroll. One hundred eleven firms reported insurance payments amounting to 12 percent or more of payroll.

Insurance payments averaged 6.5 percent of payroll, including 0.7 percent for life insurance, 5.6 percent for health insurance, and 0.2 percent not separated between life and health, as shown in Table 13. Eighty-six percent of the companies reported payments for life insurance, 94 percent reported payments for health insurance, and two percent reported combined payments for life and health insurance.

Employee payroll deductions for private pension programs were reported by 19 percent of the companies, including 15 percent of those in manufacturing and 21 percent of the nonmanufacturing firms, as shown in Table 14. Deductions were reported by 29 percent of the petroleum industry firms, but by only five percent of the chemicals and allied products industries.

While deductions for pensions averaged 0.4 percent of payroll for all companies in the survey (as shown in Table 14), they averaged 1.9 percent of payroll for those companies having deductions.

TABLE 12. Insurance* Payments, by Industry Groups, 1982

		Number of companies paying specified percent of payroll for insurance									Average insurance payments as percent of payroll	
Industry group	Total companies in survey	0%	0.1-1.9%	2.0-3.9%	4.0-5.9%	6.0-7.9%	8.0-9.9%	10.0-11.9%	12.0-13.9%	14.0% and over	All companies	Companies having insurance
Total, all industries	1,507	21	47	259	456	353	170	90	60	51	6.5	6.7
Total, all manufacturing	688	10	13	49	166	186	101	72	49	42	7.8	8.0
Manufacture of:												
Food, beverages, and tobacco	45	. . .	2	4	15	12	4	3	3	2	7.1	7.0
Textile products and apparel	38	. . .	4	7	12	10	1	1	2	1	5.6	5.7
Pulp, paper, lumber, and furniture	41	1	1	2	10	16	6	3	1	1	6.9	7.1
Printing and publishing	41	. . .	. . .	6	18	13	1	1	2	. . .	6.0	6.0
Chemicals and allied products	43	1	. . .	. . .	11	19	7	4	1	. . .	7.1	7.3
Petroleum industry	17	. . .	. . .	1	7	6	2	. . .	. . .	1	6.7	6.7
Rubber, leather, and plastic products	29	. . .	. . .	3	6	5	5	6	3	1	8.4	8.4
Stone, clay, and glass products	14	1	. . .	. . .	3	2	1	4	3	. . .	8.6	9.2
Primary metal industries	47	1	. . .	1	7	7	8	7	8	8	10.9	11.1
Fabricated metal products (excluding machinery and transportation equipment)	73	3	. . .	5	8	17	14	11	7	8	9.1	9.4
Machinery (excluding electrical)	110	. . .	2	5	19	28	17	19	11	9	8.7	8.8
Electrical machinery, equipment, and supplies	93	3	1	6	25	22	22	7	3	4	7.3	7.6
Transportation equipment	47	. . .	1	2	7	17	8	3	4	5	8.5	8.6
Instruments and miscellaneous manufacturing industries	50	. . .	2	7	18	12	5	3	1	2	6.6	6.6
Total, all nonmanufacturing	819	11	34	210	290	167	69	18	11	9	5.5	5.6
Public utilities (electric, gas, water, telephone, etc.)	151	. . .	2	19	46	61	20	1	1	1	6.2	6.2
Department stores	9	. . .	. . .	6	2	1	. . .	. . .	. . .	. . .	3.6	3.5
Trade (wholesale and other retail)	62	3	7	17	20	5	6	3	. . .	1	4.8	5.1
Banks, finance companies, and trust companies	138	. . .	1	38	66	18	8	3	2	2	5.5	5.4
Insurance companies	112	. . .	3	22	37	29	14	3	3	1	6.5	6.5
Hospitals	148	. . .	4	49	62	20	9	2	1	1	5.1	5.0
Miscellaneous nonmanufacturing industries**	199	8	17	59	57	33	12	6	4	3	5.1	5.2

**Includes net premiums paid for life, hospital, surgical, medical, and major medical insurance, plus death, surgical, and medical care payments not insured. Does not include sick leave pay.*

***Includes research, engineering, education, government agencies, construction, etc.*

Payroll deductions for insurance were reported by 76 percent of the companies, including 67 percent of the manufacturing firms and 83 percent of the nonmanufacturing firms. Deductions were reported by 89 percent of the textile products and apparel companies, but by ony 29 percent of the stone, clay, and glass products firms. Insurance deductions averaged 1.5 percent of payroll for all firms in the survey, but were 1.9 percent for those firms having deductions.

TABLE 13. Insurance Payments, by Type of Insurance, 1982

	Average insurance payments as percent of payroll, all companies				Percent of companies reporting insurance payments			Average for companies reporting specific type of insurance payments		
Industry group	Total	Life	Health	L&H*	Life	Health	L&H*	Life	Health	L&H*
Total, all industries	6.5	0.7	5.6	0.2	86	94	2	0.8	6.0	6.8
Total, all manufacturing	7.8	0.7	6.8	0.3	82	93	3	0.8	7.3	8.2
Manufacture of:										
Food, beverages, and tobacco	7.1	0.4	6.3	0.4	60	91	8	0.6	6.9	4.7
Textile products and apparel	5.6	0.6	4.8	0.2	86	94	5	0.7	5.1	4.5
Pulp, paper, lumber, and furniture	6.9	0.8	6.0	0.1	80	92	2	1.0	6.5	4.1
Printing and publishing	6.0	0.6	5.1	0.3	92	95	4	0.6	5.4	6.7
Chemicals and allied products	7.1	0.6	6.1	0.4	86	93	4	0.7	6.6	7.8
Petroleum industry	6.7	0.9	5.8	0	100	100	0	0.9	5.8	**
Rubber, leather, and plastic products	8.4	0.9	7.2	0.3	89	93	3	1.0	7.8	7.9
Stone, clay, and glass products	8.6	0.9	7.7	0	78	85	0	1.2	8.9	**
Primary metal industries	10.9	0.8	10.1	0	89	97	0	0.8	10.3	**
Fabricated metal products (excluding machinery and transportation equipment)	9.1	0.8	7.6	0.7	75	89	5	1.0	8.6	12.4
Machinery (excluding electrical)	8.7	0.7	7.8	0.2	81	97	2	0.8	8.1	8.4
Electrical machinery, equipment, and supplies	7.3	0.8	6.1	0.4	83	89	5	1.0	6.8	8.2
Transportation equipment	8.5	0.6	7.6	0.3	78	93	4	0.8	8.2	7.2
Instruments and miscellaneous manufacturing industries	6.6	0.7	5.4	0.5	92	98	2	0.7	5.5	22.6
Total, all nonmanufacturing	5.5	0.7	4.7	0.1	89	95	2	0.8	4.9	4.7
Public utilities (electric, gas, water, telephone, etc.)	6.2	0.9	5.2	0.1	94	97	2	0.9	5.4	6.2
Department stores	3.6	0.2	3.4	0	66	100	0	0.3	3.4	**
Trade (wholesale and other retail)	4.8	0.7	4.0	0.1	82	88	3	0.8	4.5	4.6
Banks, finance companies, and trust companies	5.5	0.8	4.6	0.1	95	97	2	0.8	4.7	4.3
Insurance companies	6.5	0.9	5.5	0.1	94	98	0	0.9	5.6	8.3
Hospitals	5.1	0.5	4.6	0	9.4	99	0	0.5	4.6	**
Miscellaneous nonmanufacturing industries***	5.1	0.7	4.2	0.2	78	89	4	0.9	4.6	3.8

*Companies reporting one payment for both life and health insurance (items C-4 through C-7 of questionnaire).

**No companies reported this type of payment.

***Includes research, engineering, education, government agencies, construction, etc.

TABLE 14. Employee Payroll Deductions for Pensions and Insurance, 1982

Industry group	Pensions			Insurance		
		Average deductions as percent of payroll			Average deductions as percent of payroll	
	Percent of companies reporting deductions	Total, all companies	Companies having deductions	Percent of companies reporting deductions	Total, all companies	Companies having deductions
Total, all industries	19	0.4	1.9	76	1.5	1.9
Total, all manufacturing	15	0.2	1.3	67	1.3	1.9
Manufacture of:						
Food, beverages, and tobacco	9	0.1	1.3	64	0.9	1.4
Textile products and apparel	18	0.3	1.7	89	3.2	3.6
Pulp, paper, lumber, and furniture	7	*	0.3	71	1.9	2.7
Printing and publishing	27	0.3	1.0	83	1.4	1.7
Chemicals and allied products	5	0.1	2.3	74	1.4	1.9
Petroleum industry	29	0.6	1.9	88	2.0	2.2
Rubber, leather, and plastic products	7	0.1	2.2	72	1.7	2.3
Stone, clay, and glass products	7	0.1	0.8	29	0.4	1.4
Primary metal industries	11	0.1	1.0	40	0.4	1.0
Fabricated metal products (excluding machinery and transportation equipment)	8	0.1	1.4	52	0.8	1.6
Machinery (excluding electrical)	20	0.3	1.5	58	1.0	1.6
Electrical machinery, equipment, and supplies	26	0.3	1.4	83	1.3	1.6
Transportation equipment	17	0.1	0.6	60	1.1	1.8
Instruments and miscellaneous manufacturing industries	12	0.2	1.5	78	1.1	1.5
Total, all nonmanufacturing	21	0.5	2.2	83	1.6	1.9
Public utilities (electric, gas, water, telephone, etc.)	20	0.4	2.1	83	1.5	1.8
Department stores	33	0.7	2.0	89	1.1	1.3
Trade (wholesale and other retail)	15	0.2	1.1	82	1.3	1.6
Banks, finance companies, and trust companies	10	0.2	2.0	87	1.7	1.9
Insurance companies	14	0.2	1.4	89	2.0	2.3
Hospitals	21	0.3	1.5	89	1.7	1.9
Miscellaneous nonmanufacturing industries**	36	1.1	2.9	73	1.5	2.1

*Less than 0.05%.

**Includes research, engineering, education, government agencies, construction, etc.

9. PERCENT OF COMPANIES PAYING EMPLOYEE BENEFITS

Payments for Old-Age, Survivors, Disability, and Health Insurance (FICA taxes) were reported by 99 percent of the companies surveyed, and 97 percent of the companies reported payments for Unemployment Compensation (Table 15). Eighty-six percent reported payments for vacations, and 81 percent also reported payments for holidays.

Paid sick leave was reported by 75 percent of the companies, including 59 percent of those in manufacturing and 87 percent of the nonmanufacturing firms. Profit-sharing payments were reported by 23 percent of the firms, including 41 percent of the banks, finance and trust companies, but by only 3 percent of the public utilities.

Average costs of benefit payments for companies reporting such payments are shown in Table 16. Payments for dental insurance, profit-sharing, contributions to employee thrift plans, and other benefits paid by a relatively small percentage of companies differ significantly in this table from the all-company averages shown in Table 6.

For example, profit-sharing payments for all industries are 1.1 percent of payroll, as shown in Tables 4 and 6, which are based upon all companies in the survey. However, as shown in Table 15, only 23 percent of the companies reported profit-sharing. For those companies reporting profit-sharing, this benefit was 4.8 percent of payroll, as shown in Table 16. The Chamber survey shows each benefit as a percent of the company's reported payroll. In many firms having profit-sharing only some of the employees participate in profit-sharing, and for those employees having profit-sharing, their percentage would be higher than a company average based upon all employees. Studies by other organizations show profit-sharing is about 9 or 10 percent of payroll for those employees participating in profit-sharing programs.

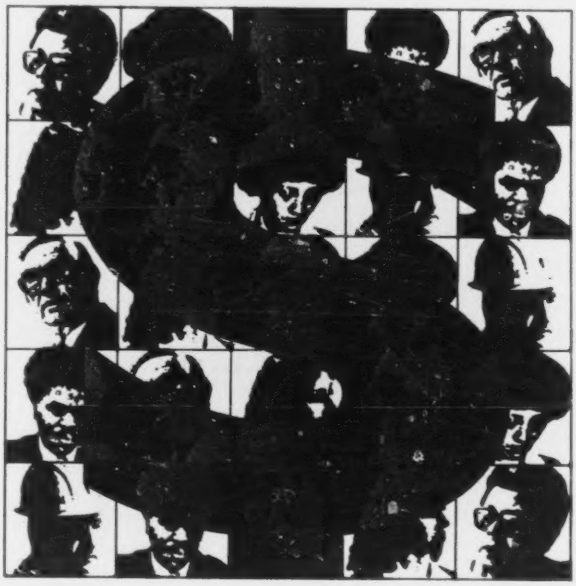


TABLE 15. Percent of Companies Paying Employee Benefits, 1982

		Manufacturing industries															Nonmanufacturing industries							
Type of benefit	Total, all industries	Total, all manufacturing	Food, beverages, and tobacco	Textile products and apparel	Pulp, paper, lumber, and furniture	Printing and publishing	Chemicals and allied products	Petroleum industry	Rubber, leather, and plastic products	Stone, clay, and glass products	Primary metal industries	Fabricated metal products (excluding mach. and trans. equipment)	Machinery (excluding electrical)	Electrical machinery, equipment, and supplies	Transportation equipment	Instruments and miscellaneous manufacturing industries	Total, all nonmanufacturing	Public utilities (electric, gas, water, telephone, etc.)	Department stores	Trade (wholesale and other retail)	Banks, finance companies, and trust companies	Insurance companies	Hospitals	Miscellaneous nonmanufacturing industries*
1. Legally required payments (employer's share only):																								
a. Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	99	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	99	100	100	98	99	100	99	98
b. Unemployment Compensation	97	98	96	100	100	95	98	100	100	100	100	99	98	98	98	98	95	99	100	94	99	100	88	93
c. Workers' compensation (including estimated cost of self-insured)	93	95	93	97	100	90	98	94	100	86	92	96	96	94	92	94	91	96	100	82	93	94	92	85
d. Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, state sickness benefits insurance, etc.	11	9	7	5	10	22	16	12	7	0	6	1	10	12	4	16	12	9	22	15	14	16	8	11
2. Pension, insurance, and other agreed-upon payments (employer's share only):																								
a. Pension plan premiums and pension payments not covered by insurance-type plan (net)	83	82	87	74	83	81	98	88	83	86	83	92	84	73	89	72	85	98	78	61	88	95	92	68
b. Life insurance premiums, death benefits; hospital, surgical, medical, and major medical insurance premiums, etc. (net)	98	99	100	100	98	100	98	100	100	93	98	96	100	97	100	100	99	100	100	95	100	100	100	97
c. Short-term disability	40	51	53	40	56	44	40	35	59	36	53	60	56	48	47	52	30	26	56	36	30	44	26	26
d. Salary continuation or long-term disability	50	38	38	24	29	49	61	65	31	36	21	27	42	39	36	48	61	60	33	37	72	74	62	55
e. Dental insurance premiums	53	57	58	24	46	56	72	77	38	43	60	52	57	69	62	58	50	59	22	47	49	50	57	43
f. Discounts on goods and services purchased from company by employees	15	9	13	21	17	22	9	18	7	0	4	7	4	2	9	12	21	25	78	31	12	19	41	4
g. Employee meals furnished by company	21	13	18	3	24	10	40	41	10	14	11	7	5	15	11	8	27	34	11	18	33	47	28	10
h. Miscellaneous payments (vision care, prescription drugs, separation or termination pay, moving expenses, etc.)	36	32	40	18	34	49	40	29	38	36	45	23	29	29	32	24	40	50	11	29	36	55	43	29
3. Paid rest periods, lunch periods, wash-up time, travel time, clothes-change time, get-ready time, etc.	67	74	69	63	76	63	72	71	69	79	66	86	76	82	60	78	62	69	56	60	60	68	72	40
4. Payments for time not worked:																								
a. Paid vacations and payments in lieu of vacation	86	89	89	79	90	98	98	82	86	86	87	92	86	88	92	82	85	95	89	74	76	89	89	80
b. Payments for holidays not worked	81	84	87	74	85	85	93	82	79	71	81	89	86	87	79	80	78	93	78	57	75	88	77	73
c. Paid sick leave	75	59	71	34	29	83	86	88	45	43	40	43	54	77	80	70	87	95	88	89	86	88	95	81
d. Payments for State or National Guard duty; jury, witness, and voting pay allowances; payments for time lost due to death in family or other personal reasons, etc.	74	76	62	55	71	76	88	100	69	71	81	74	76	80	81	78	72	93	44	48	71	75	76	61
5. Other items:																								
a. Profit-sharing payments	23	27	24	32	17	27	21	47	28	29	17	21	26	40	17	34	19	3	67	40	41	22	2	18
b. Contributions to employee thrift plans	26	23	20	8	12	20	58	59	7	7	26	10	18	23	38	30	28	46	11	19	43	36	6	20
c. Christmas or other special bonuses, service awards, suggestion awards, etc.	49	51	40	55	56	51	58	53	38	29	47	49	47	61	40	64	47	47	22	44	49	68	50	32
d. Employee education expenditures (tuition refunds, etc.)	63	52	36	34	27	61	54	77	24	29	36	48	62	71	57	62	72	80	22	40	88	88	80	52
e. Special wage payments ordered by courts, payments to union stewards, etc.	32	35	33	26	29	20	33	47	38	36	32	38	40	38	49	30	29	58	11	15	22	42	19	18

*Includes research, engineering, education, government agencies, construction, etc.

TABLE 16. Average Benefit Costs as Percent of Payroll for Companies Paying Employee Benefits, 1982

Type of benefit	Total, all industries	Manufacturing industries: Total, all manufacturing	Food, beverages, and tobacco	Textile products and apparel	Pulp, paper, lumber, and furniture	Printing and publishing	Chemicals and allied products	Petroleum industry	Rubber, leather, and plastic products	Stone, clay, and glass products	Primary metal industries	Fabricated metal products (excluding machinery and trans. equipment)	Machinery (excluding electrical)	Electrical machinery, equipment, and supplies	Transportation equipment	Instruments and miscellaneous manufacturing industries	Nonmanufacturing industries: Total, all nonmanufacturing	Public utilities (electric, gas, water, telephone, etc.)	Department stores	Trade (wholesale and other retail)	Banks, finance companies, and trust companies	Insurance companies	Hospitals	Miscellaneous nonmanufacturing industries*
1. Legally required payments (employer's share only):																								
a. Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	6.6	6.7	6.7	6.7	6.7	6.5	6.7	6.5	6.7	6.9	7.0	6.8	6.6	6.6	6.6	6.5	6.5	6.5	6.4	6.5	6.5	7.0	6.7	6.3
b. Unemployment Compensation	1.5	1.8	1.8	2.3	1.6	2.2	1.0	0.7	1.9	2.3	2.0	1.8	2.1	1.5	1.9	1.7	1.2	0.7	1.1	1.6	2.1	1.0	0.6	1.5
c. Workers' compensation (including estimated cost of self-insured)	1.5	2.2	2.8	1.7	3.0	1.0	2.1	2.2	3.8	1.8	3.9	2.9	2.3	1.2	2.1	1.3	0.8	0.9	1.4	1.6	0.3	0.3	0.8	1.3
d. Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, state sickness benefits insurance, etc.	1.0	0.8	1.4	0.2	3.2	0.4	0.2	0.1	0.5	0.0	0.6	1.2	0.4	1.4	0.9	0.4	1.2	0.4	0.2	0.2	0.6	0.2	2.0	3.3
2. Pension, insurance, and other agreed-upon payments (employer's share only):																								
a. Pension plan premiums and pension payments not covered by insurance-type plan (net)	6.0	5.7	5.9	3.0	4.5	5.4	7.1	9.2	4.2	7.1	8.8	6.5	5.4	4.8	5.5	4.0	6.3	9.4	4.2	3.7	5.7	6.7	3.7	6.5
b. Life insurance premiums, death benefits; hospital, surgical, medical, and major medical insurance premiums, etc. (net)	6.7	8.0	7.0	5.7	7.1	6.0	7.3	6.7	8.4	9.2	11.1	9.4	8.8	7.6	8.6	6.6	5.6	6.2	3.5	5.1	5.4	6.5	5.0	5.2
c. Short-term disability	0.8	0.9	1.0	0.6	0.9	0.5	1.5	0.8	0.7	1.0	1.5	0.9	0.8	0.7	1.8	0.8	0.7	0.8	0.4	0.5	0.7	0.9	0.7	0.6
d. Salary continuation or long-term disability	0.6	0.5	0.4	0.5	0.6	0.4	0.4	0.5	0.7	0.9	0.6	0.5	0.4	3.5	0.3	0.4	0.6	0.6	0.1	0.4	1.2	0.4	0.4	0.8
e. Dental insurance premiums	0.8	0.8	0.8	0.6	0.6	0.6	0.8	0.6	0.5	1.0	1.1	0.9	0.9	0.6	1.1	0.6	0.7	0.6	0.5	0.6	0.7	0.7	0.7	0.8
f. Discounts on goods and services purchased from company by employees	0.7	0.5	0.2	1.8	0.2	0.2	0.1	0.4	0.7	0.0	0.1	0.1	0.8	0.1	0.5	0.3	0.8	0.6	3.8	2.2	0.6	0.2	0.4	1.1
g. Employee meals furnished by company	0.6	0.4	0.2	0.2	0.2	0.6	0.4	0.7	0.2	0.2	0.1	0.3	0.8	0.4	0.1	0.1	0.7	0.4	0.2	0.5	0.8	1.0	0.5	1.0
h. Miscellaneous payments (vision care, prescription drugs, separation or termination pay, moving expenses, etc.)	0.7	0.8	1.5	0.4	0.9	0.6	0.4	0.5	1.3	2.5	0.7	0.7	0.6	0.7	0.7	0.4	0.7	0.5	0.0	0.5	0.5	0.9	0.7	0.7
3. Paid rest periods, lunch periods, wash-up time, travel time, clothes-change time, get-ready time, etc.	4.1	4.1	4.1	5.3	3.8	3.8	5.7	4.1	5.0	4.6	3.8	4.0	3.3	4.5	3.6	3.6	4.1	4.1	2.9	3.6	4.1	4.7	4.2	4.0
4. Payments for time not worked:																								
a. Paid vacations and payments in lieu of vacation	5.3	5.7	5.8	4.0	5.6	5.0	5.8	5.9	5.9	7.2	7.8	5.8	6.0	5.2	5.6	4.9	4.9	5.7	3.9	3.9	4.3	5.1	5.2	4.8
b. Payments for holidays not worked	3.5	3.7	3.5	3.0	3.4	3.3	3.8	3.3	3.4	3.7	3.8	3.9	3.8	3.7	4.2	3.7	3.3	3.7	2.5	2.6	3.2	3.8	2.7	3.5
c. Paid sick leave	1.7	1.3	1.1	0.5	1.0	1.6	1.8	1.9	0.7	1.3	0.7	0.8	1.0	1.4	1.8	1.5	1.9	2.1	1.0	1.0	1.6	1.8	2.1	2.0
d. Payments for State or National Guard duty; jury, witness, and voting pay allowances; payments for time lost due to death in family or other personal reasons, etc.	0.6	0.5	0.3	0.3	0.5	0.6	0.6	0.4	0.5	0.9	0.7	0.2	0.3	0.5	0.5	0.5	0.6	0.9	0.3	0.2	0.7	0.7	0.8	0.5
5. Other items:																								
a. Profit-sharing payments	4.8	4.8	2.8	3.8	7.1	8.3	6.1	6.8	5.0	1.7	4.8	5.5	5.7	3.3	3.7	3.9	4.9	3.8	2.8	5.5	5.4	4.0	3.3	5.0
b. Contributions to employee thrift plans	1.5	1.3	1.0	1.6	0.4	2.5	1.8	3.2	0.3	0.1	1.2	1.8	0.8	0.8	0.8	0.9	1.7	1.5	0.5	0.8	2.0	2.0	0.6	1.7
c. Christmas or other special bonuses, service awards, suggestion awards, etc.	0.7	0.8	0.9	0.6	1.1	1.1	1.3	1.1	0.8	0.4	0.8	1.2	0.5	0.8	0.5	0.8	0.6	0.3	0.3	0.7	1.1	0.5	0.2	0.8
d. Employee education expenditures (tuition refunds, etc.)	0.4	0.3	0.1	0.2	0.2	0.3	0.2	0.2	0.3	0.2	0.1	0.2	0.2	0.4	0.2	0.6	0.4	0.3	0.1	0.2	0.6	0.4	0.4	0.6
e. Special wage payments ordered by courts, payments to union stewards, etc.	0.6	0.5	0.4	0.4	0.1	0.5	0.6	0.4	0.4	0.3	0.6	1.0	0.8	0.3	0.6	0.3	0.6	0.6	0.0	0.3	0.5	0.7	0.3	0.9

*Includes research, engineering, education, government agencies, construction, etc.

10. PAYROLL DEDUCTIONS FOR EMPLOYEE BENEFITS

Deductions from paychecks for employee benefits totaled 8.4 percent, as shown in Table 17. Deductions included 6.5 percent for Old-Age, Survivors, Disability, and Health Insurance (FICA taxes); 0.1 percent for Railroad Retirement and state sickness benefits insurance; 0.4 percent for pension plan premiums and contributions; and 1.5 percent for life, hospital, surgical, medical, and major medical insurance.

Total deductions averaged 79.3 cents per payroll hour, or $1,619 per year per employee.

Deductions were 10.3 percent for textile products and apparel companies, 9.4 percent for petroleum firms, and 9.2 percent for insurance companies, but only 6.7 percent for stone, clay, and glass products.

As cents per payroll hour, they ranged from 125.7 cents for the petroleum industry to 48.6 cents for department stores.

As dollars per year per employee they varied from $2,625 for the petroleum industry to $951 for department stores.

TABLE 17. Payroll Deductions for Employee Benefits, 1982

Industry group	Deductions as percent of payroll						
	Total deductions	Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	Railroad Retirement and state sickness benefits insurance taxes	Pension plan premiums or contributions	Life, hospital, surgical, medical, and major medical insurance	Total deductions as cents per payroll hour	Total deductions as dollars per year per employee
Total, all industries	8.4	6.5	0.1	0.4	1.5	79.3	1,619
Total, all manufacturing	8.1	6.6	0.1	0.2	1.3	77.4	1,581
Manufacture of:							
Food, beverages, and tobacco	7.6	6.6	*	0.1	0.9	69.4	1,456
Textile products and apparel	10.3	6.7	*	0.3	3.2	62.8	1,223
Pulp, paper, lumber, and furniture	8.6	6.7	*	*	1.9	75.4	1,577
Printing and publishing	8.3	6.5	0.1	0.3	1.4	83.9	1,675
Chemicals and allied products	8.2	6.7	*	0.1	1.4	84.4	1,762
Petroleum industry	9.4	6.6	0.3	0.6	2.0	125.7	2,625
Rubber, leather, and plastic products	8.6	6.7	0.1	0.2	1.7	73.8	1,499
Stone, clay, and glass products	6.7	6.2	0.1	0.1	0.4	68.7	1,386
Primary metal industries	7.6	7.0	*	0.1	0.4	74.7	1,497
Fabricated metal products (excluding machinery and transportation equipment)	7.4	6.4	*	0.1	0.8	66.3	1,363
Machinery (excluding electrical)	7.9	6.6	*	0.3	1.0	87.6	1,765
Electrical machinery, equipment, and supplies	8.4	6.6	0.1	0.4	1.3	75.1	1,544
Transportation equipment	7.8	6.6	0.1	0.1	1.1	82.6	1,698
Instruments and miscellaneous manufacturing industries	7.7	6.3	0.1	0.2	1.1	69.6	1,430
Total, all nonmanufacturing	8.6	6.4	0.1	0.5	1.6	80.9	1,652
Public utilities (electric, gas, water, telephone, etc.)	8.4	6.4	0.1	0.4	1.5	94.4	1,975
Department stores	8.4	6.4	0.2	0.7	1.1	48.6	951
Trade (wholesale and retail)	8.0	6.4	0.1	0.2	1.3	63.2	1,294
Banks, finance companies, and trust companies	8.5	6.5	0.1	0.2	1.7	67.7	1,374
Insurance companies	9.2	7.0	*	0.2	2.0	79.0	1,569
Hospitals	8.6	6.6	0.1	0.3	1.7	71.1	1,474
Miscellaneous nonmanufacturing industries**	8.6	5.9	0.1	1.1	1.5	95.1	1,921

**Less than 0.05%.*

***Includes research, engineering, education, government agencies, construction, etc.*

11. WAGE AND PAYROLL DATA

Hourly and annual earnings data, together with several payroll items sometimes considered employee benefits, are shown in Table 18.

Highest hourly earnings of $13.34 were reported by the petroleum industry. Lowest were department stores paying $5.81. On an annual basis, the highest paying was again the petroleum industry, with $27,829 per full-time employee, and lowest were department stores, paying $11,412.

The average payroll for all companies surveyed was composed of 94.0 percent payments for straight time, 2.9 percent premium pay for overtime, 0.7 percent holiday premium pay, 0.5 percent shift differential, 1 percent incentive or production bonus, and 0.9 percent for other payroll items.

If employees received regular pay for holidays, but did not work on these days, such payments are reported as employee benefits in other tables of this report (item 4-b of Tables 4, 6, 7, 8, etc.). If the employee worked on holidays and received $8 per hour for regular straight time worked, but $12 per hour for holiday work, for each hour of holiday work $8 would be reported in Table 18 as straight time and $4 as holiday premium pay.

Payroll data in Table 18 are shown as percent of payroll and cents per payroll hour, but can be converted to dollars per year per employee by using as multipliers the annual figures given in the last column of the table.

Employee benefits are numerous, and there are differences of opinion regarding just what constitutes the benefit package and how it should be computed. Should workers' compensation, suggestion awards, and similar items be included? Should shift differentials, overtime premium pay, etc., be included? Should the base be gross payroll or straight-time pay for time actually worked?

Three methods of computation are illustrated in Chart 2. In this study benefits are shown as 36.7 percent of payroll, (or, 36.4 percent—see note on Chart 2), with benefits averaging $7,187 per year per employee and total gross payroll of $19,749.

However, if the computation base is changed to "straight-time pay for time worked," or $16,259, the $7,187 in benefits average 44.2 percent.

If overtime and holiday premium pay, shift differentials, production bonus, and other miscellaneous payroll items are also considered benefits, the benefits total $8,372. Compared with the $16,259 of straight-time pay for time worked, the benefits are 51.5%.

TABLE 18. Wage Data, by Industry Groups, 1982

Industry group	Average hourly earnings as percent of payroll							Average hourly earnings as cents per hour							
	Total payroll	Straight-time pay	Overtime premium pay*	Holiday premium pay*	Shift differential	Earned incentive or production bonus	Other	Total payroll	Straight-time pay	Overtime premium pay*	Holiday premium pay*	Shift differential	Earned incentive or production bonus	Other	Total payroll dollars per year per full-time employee
Total, all industries	100.0	94.0	2.9	0.7	0.5	1.0	0.9	968	909	28	7	5	11	9	19,749
Total, all manufacturing	100.0	93.0	3.0	1.0	0.6	1.4	0.9	970	900	29	11	6	15	10	19,816
Manufacture of:															
Food, beverages, and tobacco	100.0	92.8	4.2	0.8	0.9	0.8	0.5	910	842	38	8	8	9	6	19,071
Textile products and apparel	100.0	94.1	2.8	1.4	0.4	0.7	0.6	604	568	17	9	2	4	4	11,762
Pulp paper, lumber, and furniture	100.0	91.1	4.5	1.8	0.5	1.5	0.6	891	805	43	18	5	15	6	18,809
Printing and publishing	100.0	94.8	1.9	0.7	0.3	1.3	1.0	1,033	975	19	7	3	16	13	20,550
Chemicals and allied products	100.0	93.1	4.1	0.8	0.8	0.5	0.7	1,039	966	43	9	9	6	7	21,647
Petroleum industry	100.0	92.3	4.8	1.4	0.8	0.2	0.5	1,334	1,230	63	21	10	2	9	27,829
Rubber, leather, and plastic products	100.0	91.8	2.9	0.8	0.7	2.5	1.3	852	784	25	8	6	18	12	17,300
Stone, clay, and glass products	100.0	89.8	6.1	1.3	1.2	0.6	1.1	1,049	937	68	13	12	6	13	21,058
Primary metal industries	100.0	90.7	2.9	1.5	0.7	2.9	1.3	1,051	955	27	15	7	33	14	21,068
Fabricated metal products (excluding machinery and transportation equipment)	100.0	93.0	2.5	0.8	0.5	2.2	0.9	905	835	24	8	5	23	10	18,602
Machinery (excluding electrical)	100.0	93.2	2.5	0.9	0.5	2.0	0.8	1,125	1,044	26	17	6	22	10	22,640
Electrical machinery, equipment, and supplies	100.0	94.6	2.1	0.8	0.4	0.9	1.1	906	857	18	8	4	8	11	18,633
Transportation equipment	100.0	91.8	3.3	1.1	1.0	1.2	1.5	1,065	980	36	11	11	12	15	21,873
Instruments and miscellaneous manufacturing industries	100.0	94.1	2.5	0.8	0.5	1.0	1.0	891	837	22	8	4	10	11	18,291
Total, all nonmanufacturing	100.0	94.9	2.7	0.4	0.5	0.7	0.8	966	916	26	4	4	7	8	19,692
Public utilities (electric, gas, water, telephone, etc.)	100.0	93.9	4.8	0.4	0.3	0.1	0.5	1,132	1,062	56	5	3	1	6	23,690
Department stores	100.0	98.1	0.8	0.6	0.1	0.4	**	581	570	5	3	1	2	***	11,412
Trade (wholesale and other retail)	100.0	93.0	3.5	0.7	0.1	1.4	1.4	806	748	29	5	1	13	11	16,509
Banks, finance companies, and trust companies	100.0	96.2	2.1	0.2	0.3	0.8	0.5	823	790	15	2	2	7	6	16,693
Insurance companies	100.0	96.9	1.4	0.3	0.1	1.0	0.4	906	879	11	3	1	9	3	17,990
Hospitals	100.0	93.7	2.4	0.8	1.6	0.1	1.4	842	790	20	6	14	1	12	17,462
Miscellaneous nonmanufacturing industries****	100.0	94.9	2.5	0.4	0.2	1.1	0.9	1,133	1,076	25	4	3	15	10	22,720

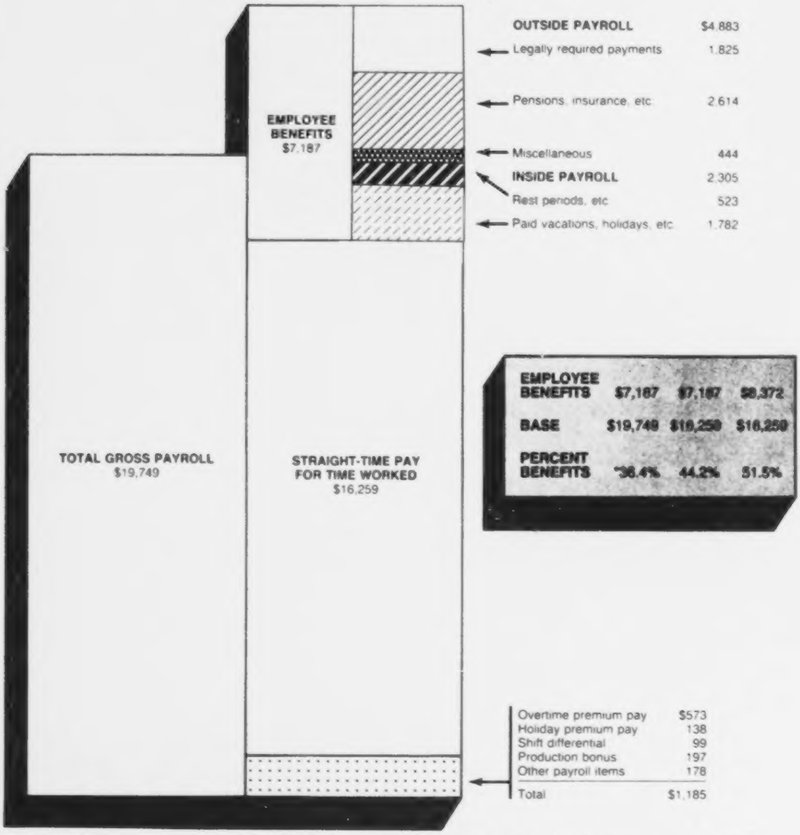
**Includes bonus or premium pay only. If employee receives $8.00 per hour for straight time and $12.00 for overtime, for each overtime hour worked, $8.00 would be shown as straight-time pay and $4.00 as overtime pay.*

***Less than 0.05%.*

****Less than 0.5¢.*

*****Includes research, engineering, education, government agencies, construction, etc.*

CHART 2. Annual Employee Benefits and Earnings per Employee, 1982



*This percent of payroll figure varies slightly from the 36.7 percent shown in tables, such as Tables 6 and 8. The slight discrepancy results from rounding

12. TOTAL EMPLOYEE BENEFIT COSTS

Total employee benefit costs are estimated at $510 billion for 1982, as shown in Table 19. Costs in manufacturing industries are estimated at $141 billion, or 36.7 percent of the $383.8 billion paid in wages and salaries. Service industry benefits are estimated at $69 billion, or 25 percent of the $276.3 billion in wages and salaries. Benefits in wholesale and retail trade are estimated at $73 billion; finance, insurance, and real estate at $38.5 billion; construction at $21.5 billion; transportation at $23.8 billion; utilities and communication at $24.2 billion; mining at $12.7 billion; agriculture at $2.3 billion; and federal, state and local government benefits at $104 billion.

Total benefits for 1929 are estimated at $1.5 billion, or 3 percent of that year's $50.4 billion in wages and salaries (Table 20). There were no Old-Age, Survivors, Disability, and Health Insurance or Unemployment Compensation programs. The only legally required payments were workers' compensation and government employees' retirement, totaling 0.8 percent.

Agreed-upon programs in 1929 are estimated at 0.4 percent, including small amounts for private pension and insurance programs. Rest periods are estimated at 1 percent, and time paid for but not worked is estimated at 0.7 percent. In 1929, vacations and paid holidays were usually limited to office workers, with the one-week vacation common, and paid holidays considerably fewer than today. Bonuses, profit-sharing, and other miscellaneous benefits in 1929 are estimated at 0.1 percent.

Benefits for 1951 are estimated at 15 percent of wages and salaries, or $26 billion. This includes 3.3 percent for legally required payments; 2.7 percent for pensions, insurance and other agreed-upon payments; 2.5 percent for rest periods; 5.5 percent for vacations, holidays, sick leave and other time not worked; and one percent for bonuses, profit-sharing, and other miscellaneous payments.

The 1961 benefits are estimated at 21 percent of wages and salaries, or $58.5 billion. This includes 5.1 percent for legally required payments, 4.6 percent for agreed-upon payments, 3.2 percent for rest periods, 7.1 percent for time not worked, and one percent for other benefits.

Benefit payments for 1971 are estimated to have reached $150 billion, or 26 percent of payroll. Legally required payments are estimated at 7.2 percent; agreed-upon payments at 5.9 percent; rest periods, 3.6 percent; time not worked, 8.4 percent, and bonuses, profit-sharing payments, etc., 0.9 percent.

Total 1982 benefits are estimated at 32.5 percent of payroll. This includes 9.5 percent for legally required payments, 8.5 percent for pension, insurance, and other agreed-upon payments; and 3.8 percent for rest periods. Vacations, holiday, sick leave, and other time not worked is estimated at 9.8 percent, and bonuses, profit-sharing, and other miscellaneous payments at 0.9 percent.

TABLE 19. Estimated Total Employee Benefits Payments, 1982

Industry	Wages and salaries (Billion dollars)	Benefit payments	
		Percent	Billion dollars
Manufacturing	$ 383.8	36.7%	$141.0
Services	276.3	25.0	69.0
Trade (wholesale and retail)	260.0	28.1	73.0
Finance, insurance, and real estate	97.9	39.3	38.5
Construction	78.8	27.3	21.5
Transportation	61.8	38.5	23.8
Utilities and communication	57.0	42.5	24.2
Mining	31.0	41.0	12.7
Agriculture	15.6	14.7	2.3
Private industry	1,262.1	32.1	406.0
Government (federal, state, local)	306.0	34.0	104.0
Total, all industries	$1,568.1	32.5%	$510.0

SOURCES: Wages and salaries data from United States Department of Commerce.
Employee benefit data estimated by Chamber of Commerce of the United States.

TABLE 20. Growth of Employee Benefits, 1929 to 1982

Type of payment	1929	1951	1961	1971	1982
	(Percent of wages and salaries)				
1. Legally required	0.8%	3.3%	5.1%	7.2%	9.5%
Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	0	1.0	2.1	3.7	5.2
Unemployment Compensation	0	1.0	1.1	0.7	1.1
Workers' compensation	0.6	0.6	0.7	1.0	0.9
Government employee retirement	0.2	0.6	1.0	1.5	2.0
Other	0	0.1	0.2	0.3	0.3
2. Agreed-upon	0.4	2.7	4.6	5.9	8.5
Pensions	0.2	1.8	2.6	3.0	3.6
Insurance	0.1	0.7	1.7	2.6	4.4
Other	0.1	0.2	0.3	0.3	0.5
3. Rest periods	1.0	2.5	3.2	3.6	3.8
4. Time not worked	0.7	5.5	7.1	8.4	9.8
Vacation	0.3	3.0	3.8	4.3	5.0
Holidays	0.3	1.8	2.4	2.9	3.3
Sick leave	0.1	0.6	0.8	1.0	1.3
Other	0	0.1	0.1	0.2	0.2
5. Bonuses, profit-sharing, etc.	0.1	1.0	1.0	0.9	0.9
Total benefit payments	3.0%	15.0%	21.0%	26.0%	32.5%
	(Billion dollars)				
Wages and salaries	$50.4	$171.1	$278.8	$573.4	$1,568.1
Total benefit payments	$ 1.5	$ 26.0	$ 58.5	$150.0	$ 510.0

Source: Estimated by Chamber of Commerce of the United States.

13. SUPPLEMENTS TO WAGES AND SALARIES

The United States Department of Commerce publishes some employee benefits data in its National Income statistics. Listed as supplements to wages and salaries, and covering the period 1929 to date, they consist chiefly of legally required payments and expenditures for private pension and welfare plans (items B and C of the Chamber questionnaire). These costs grew from $0.7 billion in 1929 to $297.6 billion in 1982, as shown in Table 21 and Chart 3. The 1982 costs averaged 19.0 percent of wages and salaries for all industries, but ranged from 13.8 percent for agriculture, forestry, and fisheries industries and 14.2 percent for services to 26.4 percent for electric, gas, and sanitary services, and 32.2 percent for communication.

TABLE 21. Supplements to Wages and Salaries, 1929 to 1982

(United States Department of Commerce Data)

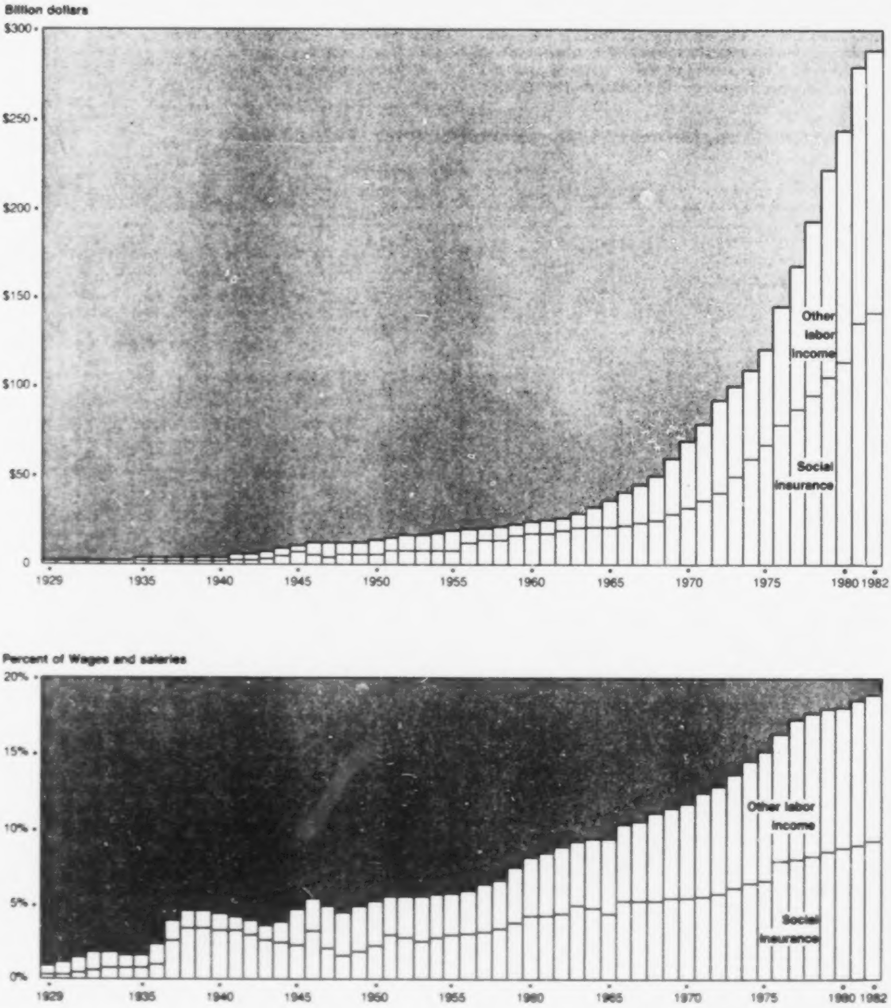
Item	1929	1935	1940	1945	1950	1955	1960	1965	1970	1975	1980	1982
	Million dollars*											
Total supplements to wages and salaries	662	650	2,311	5,604	7,818	13,238	23,000	34,538	63,240	124,980	242,543	297,565
Employer contributions for social insurance	101	171	1,624	3,805	4,164	6,216	11,780	16,698	30,733	60,457	115,297	140,944
Federal social insurance funds	29	44	1,469	3,580	3,482	4,957	9,645	13,668	24,889	48,921	92,935	115,079
Old-Age, Survivors, and Disability Insurance			329	630	1,308	2,825	5,632	8,330	16,182	30,490	55,623	69,191
Hospital insurance									2,342	5,610	11,623	16,430
State unemployment insurance		7	813	1,011	1,217	1,221	2,300	3,076	2,493	5,516	12,073	13,172
Federal unemployment tax			98	174	232	304	343	558	854	1,294	3,463	4,084
Federal civilian employee retirement	21	32	93	227	316	144	838	1,146	2,215	4,353	7,446	9,131
Other items	8	5	136	1,538	409	463	532	558	803	1,658	2,707	3,131
State and local social insurance funds	72	127	155	225	682	1,259	2,135	3,030	5,844	11,536	22,362	25,865
State and local employee retirement	72	127	155	225	510	985	1,775	2,525	5,091	10,170	19,103	22,700
Other items					172	274	360	505	753	1,366	3,259	3,165
Other labor income	561	479	687	1,799	3,654	7,022	11,220	17,840	32,507	64,523	127,246	156,621
Employer contributions to private pension and welfare funds	169	180	282	1,132	3,534	6,845	10,969	17,485	31,937	63,595	125,439	154,465
Pension and profit-sharing					1,713	3,377	4,866	7,646	13,050	28,253	54,694	65,237
Group health insurance					781	1,706	3,374	5,890	12,099	24,043	48,949	65,687
Group life insurance					249	561	1,080	1,651	2,891	4,368	6,203	7,173
Workers' compensation					791	1,150	1,529	2,177	3,786	6,695	15,248	15,936
Supplemental unemployment						51	120	121	111	236	345	432
Other items	392	299	405	667	120	177	251	355	570	928	1,807	2,156
	Total supplements as percent of wages and salaries											
All industries	1.3	1.8	4.6	4.8	5.3	6.3	8.5	9.5	11.5	15.5	17.9	19.0
Agriculture, forestry, and fisheries	0.4	0.5	0.6	0.4	0.6	1.9	4.7	5.6	7.4	10.7	13.4	13.8
Mining	1.6	1.7	5.7	4.0	9.4	10.5	12.2	12.8	15.3	18.5	18.0	19.5
Contract construction	2.3	3.5	6.6	5.3	5.9	6.5	7.0	8.5	9.9	12.5	14.2	15.4
Manufacturing	0.9	1.2	5.2	5.1	6.6	8.3	10.8	12.0	14.4	19.6	22.9	23.5
Transportation	2.0	2.7	6.2	6.0	6.6	7.4	9.6	10.6	12.7	18.7	19.6	21.7
Communication	2.1	4.4	8.8	8.9	10.1	8.9	11.1	18.2	24.0	28.9	29.5	32.2
Electric, gas, and sanitary services	1.7	2.2	6.2	9.4	9.2	10.6	12.6	14.4	16.8	22.6	24.1	26.4
Wholesale and retail trade	0.6	0.8	3.9	3.4	3.8	4.3	6.4	7.6	9.4	11.9	13.8	15.4
Finance, insurance, and real estate	2.4	2.6	6.0	5.1	6.1	7.5	9.6	11.4	13.3	17.8	18.8	20.4
Services	0.4	0.6	2.4	2.2	2.5	3.3	5.1	6.2	7.9	11.5	13.0	14.2
Government and government enterprises	3.2	3.4	4.1	5.3	4.2	4.1	7.2	7.9	10.0	14.2	17.7	18.8
All private enterprises	1.1	1.4	4.8	4.5	5.5	6.7	8.7	9.9	11.9	15.9	17.9	19.0

*Due to changes in classification, 1929-45 data are not strictly comparable with more recent data.

**Data not available.

Source: United States Department of Commerce data. Percentages computed by Chamber of Commerce of the United States.

CHART 3. Supplements to Wages and Salaries, 1929 to 1982



14. HOW EMPLOYEE BENEFITS WERE SURVEYED

As in earlier studies, it was necessary to go directly to employers for the basic data on employee benefits. The mailing list included previous participants in the surveys, firms in the Survey Research Center's business samples, names from *Fortune's* lists and from Polk's World Bank directory, and firms from the directory of the American Compensation Association. Questionnaires also were sent to firms requesting that they be included in the survey. Questionnaires were sent to some of their members by the Hospital Association of New York State, the Kansas City Area Hospital Association, a group of Baltimore hospitals, and the American Paper Institute.

There were 1,507 respondents from the 8,522 companies in the sample, an 18 percent response rate.

In 1982, for the first time, the sample included firms with *fewer than 100* employees, making the sample more representative of the business community.

Companies with fewer than 500 employees constituted 42 percent *of the total respondents* in 1982, compared with 41 percent in 1981.

If the results from this survey of 1982 benefits are compared with earlier surveys, one should be aware of several factors that could affect the findings. The sample size was increased, and the number of respondents increased by 52 percent, from 994 in 1981 to 1,507. The composition of the sample was affected by the inclusion of firms having fewer than 100 employees and the inclusion of firms from the Survey Research Center's samples of the business community. The severity and depth of the 1981-1982 recession had a substantial impact during 1982 on the composition of employers' work forces and on the number of hours worked. Adjustments in pension benefits were being made by some companies. Business firms around the nation were striving to contain employee benefits costs which had been burgeoning for years.

EMPLOYEES COVERED

This study is, in general, limited to employees who are not exempt from the Fair Labor Standards Act. Pay of workers covered by this survey varies with the number of hours worked. However, for banks, financial institutions, etc., all nonsupervisory employees and working supervisors are included, regardless of their method of wage payment.

COMPUTATION METHOD

The method of computation used in this study is outlined below. Also shown is a procedure for computing a company's benefit payments on a basis comparable to that used in this report.

In combining company data to form industry averages, the percentages for individual companies were added together without weighting. Otherwise, data for a few large companies might obscure the data of many small firms. Also, this procedure tended to compensate for the lower percentage coverage of smaller firms.

YOUR COMPANY'S EMPLOYEE BENEFITS

After the Chamber's previous benefits studies were published, several companies inquired how their data might be compiled on a comparable basis. This can be done by completing the questionnaire on pages 32-34 and performing the following computations.

1. Total benefit payments (Questionnaire items B through F) .... $______
2. "Full-time equivalent" employees (In questionnaire item H divide the hours for all employees by the hours for a full-time employee) .... ______

Employee benefit payments as:

Percent of payroll (Item 1 above divided by questionnaire item A-7) .... ______

Cents per payroll hour (Item 1 above divided by the hours for all employees in questionnaire item H) .... ______

Dollars per year per employee (Item 1 above divided by item 2 above) .... ______

	Our Company	Our Industry	All Manufacturing	All non-Manufacturing	All Industries
Employee benefits as:					
Percent of payroll	______%	______%	39.1%	34.6%	36.7%
Cents per payroll hour	______¢	______¢	381.0¢	328.2¢	352.3¢
Dollars per year per employee	$______	$______	$7,771	$6,697	$7,187

15. COPY OF QUESTIONNAIRE USED IN SURVEY

INSTRUCTIONS

EMPLOYEE BENEFITS SURVEY—1982

THIS SURVEY IS CONFIDENTIAL

Data of individual firms will not be disclosed. Data furnished will be published only in the form of totals for groups of companies. Only persons handling the research will see your report.

1. **COVERAGE.** If you have several divisions or plants, data covering any typical group of employees will be satisfactory.
2. **EMPLOYEES COVERED IN SURVEY.** Except for banks, financial institutions, etc., limit data included in this report to hourly rated employees and to salaried employees who are paid on a similar basis. That is, include data for salaried employees if their pay varies depending on whether they work overtime, or less than full time, but do not include them if they receive their regular daily or weekly pay regardless of hours worked. Since this definition would exclude many employees of **banks, financial institutions, etc.,** for these firms please include all nonsupervisory employees and all working supervisors, regardless of their method of payment. Please exclude all officers of company. **Hospitals** having difficulty making this employee separation can also include data for all employees.
3. **APPROXIMATE OR INCOMPLETE DATA.** If you are unable to give exact data for the various items in the questionnaire, please give estimates—we would prefer a good estimate to a blank space. If you are unable to break down the data on payments exactly as we have outlined it, please give the data that is available. Please indicate the items for which payments were made, but for which you cannot give separate figures.
4. **QUESTION A. GROSS PAYROLL DATA.** For this item, report actual wages (not take-home pay after deductions have been made). Report on line A-1 the straight-time wages for all hours, including pay for time not worked, plus payments in lieu of vacations and holidays. Report premium and bonus payments on other lines. Thus, if an employee's rate is $8.00 an hour for straight time and $4.00 additional for overtime after 40 hours, for each hour of overtime worked after 40 hours, $8.00 would be entered on line A-1, and $4.00 on line A-2.
5. **ITEMS C-1, C-4, and C-6. PENSION AND INSURANCE PREMIUMS.** For pension and insurance premiums, report net payments after deducting any dividends or credits returned to employer by insurer. In **pension programs** the company's long-term commitment is fixed, not tied to profits. Profit-sharing payments are reported as Item F-1.
6. **ITEM C-4. LIFE INSURANCE.** Exclude premiums for life insurance purchased under a pension plan. Such premiums should be reported under Item C-1.
7. **ITEM C-6. MEDICAL CARE INSURANCE.** Include premiums which supplement Medicare coverage of retired employees.
8. **ITEM F-1. PROFIT-SHARING PAYMENTS.** Company contributions are based on current profits of the business, fluctuating with current profit levels.
9. **ITEM F-2. CONTRIBUTIONS TO EMPLOYEE THRIFT PLANS.** Company contributions are not tied to current profit levels, but are a fixed proportion of amount contributed by employees.
10. **QUESTION G. EMPLOYEE PAYROLL DEDUCTIONS.** For this question report deductions from employee pay. Employer contributions are reported in questions B and C.
11. **QUESTION H. EMPLOYEE HOURS.** This is the number of hours worked or paid for, corresponding to earnings given on line A-1. **Employee hours for full-time employee.** Report the total number of hours for a typical full-time employee in 1982. It would be the number of hours representing the wages shown on line A-1, including paid vacation period, paid holidays, paid sick leave, etc. If hours would not be the same for all employees, show hours for the majority of employees.

Please return the filled-out questionnaire to:
EMPLOYEE BENEFITS SURVEY/ECONOMIC POLICY DIVISION
CHAMBER OF COMMERCE OF THE UNITED STATES/WASHINGTON, D.C. 20062

CONFIDENTIAL

EMPLOYEE BENEFITS SURVEY—1982

Show actual data or best estimate for employees covered in survey.

Total amount for 1982

A. GROSS PAYROLL FOR EMPLOYEES IN SURVEY: (See Instructions No. 4)

1. Straight time for employees in survey .... $ ________
2. Overtime premium pay .... $ ________
3. Holiday premium pay .... $ ________
4. Shift differential .... $ ________
5. Earned incentive or production bonus .... $ ________
6. Other (Specify: ________) $ ________
7. Total gross payroll .... $ ________

Include **BONUS AND PREMIUM PAY ONLY** on lines 2-6. Report straight-time pay on line 1.

B. LEGALLY REQUIRED PAYMENTS (employer's share only):

1. Old-Age, Survivors, Disability, and Health Insurance (employer FICA taxes) .... $ ________
2. Unemployment Compensation (federal and state taxes) .... $ ________
3. Workers' Compensation (estimate cost if self-insured) .... $ ________
4. Railroad Retirement Tax .... $ ________
5. Railroad Unemployment and Cash Sickness Insurance .... $ ________
6. State sickness benefits insurance .... $ ________
7. Other (Specify: ________) $ ________
8. Total .... $ ________

C. VOLUNTARY OR AGREED-UPON PAYMENTS (employer's share only):

1. Pension plan premiums under insurance and annuity contracts (net) (See Instructions No. 5) .... $ ________
2. Payments to uninsured trusteed pension plans .... $ ________
3. Pension payments under unfunded pension programs .... $ ________
4. Life insurance premiums (net) (See Instructions Nos. 5 and 6) .... $ ________
5. Death benefits not covered by insurance .... $ ________
6. Hospital, surgical, medical, and major medical insurance premiums (net) (See Instructions No. 7) .... $ ________
7. Hospital, surgical, medical, and major medical payments self-insured .... $ ________
8. Short-term disability, sickness or accident insurance (company plan or insured plan) .... $ ________
9. Salary or wage continuation or long-term disability (insured, self-administered, or trust) .... $ ________
10. Dental insurance premiums .... $ ________
11. Discounts on goods and services purchased from company by employees .... $ ________
12. Employee meals furnished by company .... $ ________
13. Child care .... $ ________
14. Parking .... $ ________
15. Physical and mental fitness programs .... $ ________
16. Other (vision care, prescription drugs, etc. Specify: ________) $ ________
17. Total .... $ ________

For Office Coding—Leave Blank

1
27
33
34
40
46
53
59
65
71
6
12
18
24

CONFIDENTIAL

	Total amount for 1982	For Office Coding—Leave Blank
D. PAID REST PERIODS, COFFEE BREAKS, LUNCH PERIODS, WASH-UP TIME, TRAVEL TIME, CLOTHES-CHANGE TIME, GET-READY TIME, ETC.	$	27
E. PAYMENTS FOR TIME NOT WORKED:		
1. Payments for or in lieu of vacations	$	30
2. Payments for or in lieu of holidays not worked	$	
3. Sick leave pay	$	36
4. Payments required under guaranteed workweek or work year	$	
5. Jury, witness, and voting pay allowances	$	
6. National Defense, State or National Guard duty	$	
7. Payment for time lost due to death in family or other personal reasons	$	
8. Maternity leave pay	$	
9. Other (Specify:)	$	39
10. Total	$	
F. OTHER ITEMS:		
1. Profit-sharing payments (See Instructions No. 8)		
(a) Current cash payments	$	42
(b) Payments to deferred profit-sharing trusts	$	
2. Contributions to employee thrift or stock purchase plans (See Instructions No. 9)	$	48
3. Christmas or other special bonuses (not tied to profits), service awards suggestion awards, etc.	$	
4. Employee education expenditures (tuition refunds, seminar attendance, etc.)	$	54
5. Payments to union stewards or officials for time spent in settling grievances or in negotiating agreements	$	
6. Special wage payments ordered by courts, wage adjustment boards, etc.	$	
7. Other (Specify:)	$	57
8. Total	$	
G. EMPLOYEE PAYROLL DEDUCTIONS: (See Instructions No. 10)		
1. Old-Age, Survivors, Disability, and Health Insurance (employee FICA taxes)	$	60
2. Railroad Retirement Tax	$	
3. State sickness benefits insurance tax	$	
4. Pension plan premiums or contributions	$	
5. Life insurance premiums	$	66
6. Hospital, surgical, medical, and major medical insurance premiums or contributions	$	
7. Other (Specify:) Do not include deductions for income tax	$	69
8. Total	$	

H. EMPLOYEE HOURS (hours worked or paid for, including time actually worked, plus holidays, vacation, sick leave, and other time paid for but not worked) (See Instructions No. 11):

1. Total hours of **all employees** in survey during 1982		72
2. Total hours of **a typical full-time employee** during 1982		76

I. PRIMARY STANDARD INDUSTRIAL CLASSIFICATION CODE ____________

(Or type of business and principal lines or products manufactured or handled:)

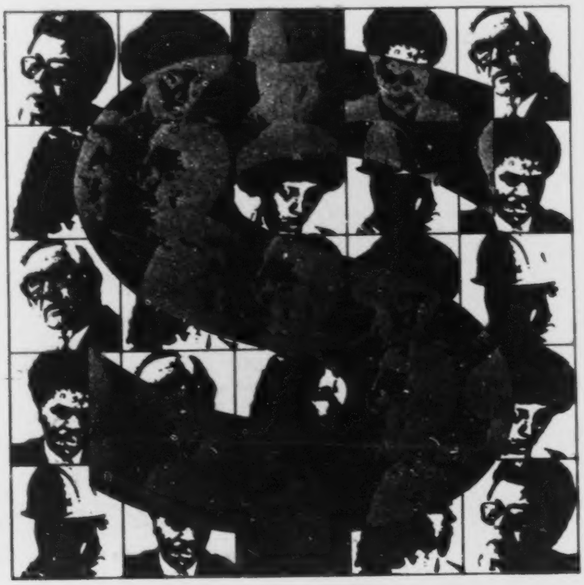
Please return the filled-out questionnaire to:
EMPLOYEE BENEFITS SURVEY/ECONOMIC POLICY DIVISION
CHAMBER OF COMMERCE OF THE UNITED STATES/WASHINGTON, D.C. 20062

EMPLOYEE BENEFITS—NO LONGER "FRINGE" BENEFITS

This report of the U.S. Chamber's survey of employee benefits for 1982 marks the twenty-first benefits survey conducted by the Chamber, which has been surveying the growth of, and changes in, benefits since 1947.

Initially conducted every other year, these surveys are now made annually. Employee benefits, once called "fringe" benefits, amounted to more than one-third of payroll dollars in 1982. Employers spend record amounts for such benefits every year.

The survey of 1983 benefits is under way, and publication is scheduled for November 1984.



1951-1979

EMPLOYEE BENEFITS HISTORICAL DATA

U.S. Chamber of Commerce

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Introduction

In response to increasing demand for historical employee benefits data, the Chamber of Commerce has prepared this report summarizing our employee benefits reports from 1951 through 1979.

This report traces the growth of employee benefits from 18.7% of payroll in 1951 to 36.6% in 1979, approximately double the 1951 percentage. As cents per payroll hour, benefits grew from 31.5¢ in 1951 to $2.676 in 1979, an increase of 750%. As dollars per year per employee, the increase was similarly spectacular—from $644 in 1951 to $5,560 in 1979. For the total United States economy, benefits grew from $1.5 billion in 1929 to $390 billion in 1979.

This benefit growth occurred in four ways: (1) New benefits were introduced. Vision insurance, dental insurance, short-term disability, long-term disability, and legal insurance are among the most recently introduced benefits. (2) Benefits increased in cost. The employer social security tax, from 1937 through 1949, was 1% of the first $3,000 of wages and salaries, with a maximum tax of $30. The 1981 employer tax is 6.65% of the first $29,700 of wages and salaries, with a maximum tax of $1,975.05. Pension costs grew from 3.6% of payroll in 1951 to 5.4% in 1979, while insurance costs increased from 1.4% in 1951 to 5.7% in 1979. (3) Duration of benefits increased. Our 1951 survey reported vacations averaged eight days per year, holidays five days, and sick leave 1.5 days. The 1979 survey reported vacations were twelve days, holidays eight days, and sick leave three days. (4) More employees were covered by benefits. Social Security covered only 60% of the wage and salary workers in 1950, but now covers about 90%. Many benefits were first limited to office and professional workers, but were later extended to blue collar workers.

We wish to thank the thousands of employers who have searched their records, and submitted the data which made these surveys possible.

This report was prepared in the U.S. Chamber's Survey Research Center, Economic Policy Division, by Fred D. Lindsey, Consultant.

RICHARD W. RAHN
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Chief Economist

June 1981

Notes Regarding Tables

The Chamber of Commerce has conducted eighteen employee benefits surveys. The surveys were titled: THE HIDDEN PAYROLL (1947 benefits), WAGE SUPPLEMENTS (1949 benefits), FRINGE BENEFITS 1951, FRINGE BENEFITS 1953, FRINGE BENEFITS 1955, FRINGE BENEFITS 1957, FRINGE BENEFITS 1959, FRINGE BENEFITS 1961, FRINGE BENEFITS 1963, FRINGE BENEFITS 1965, EMPLOYEE BENEFITS 1967, EMPLOYEE BENEFITS 1969, EMPLOYEE BENEFITS 1971, EMPLOYEE BENEFITS 1973, EMPLOYEE BENEFITS 1975, EMPLOYEE BENEFITS 1977, EMPLOYEE BENEFITS 1978, EMPLOYEE BENEFITS 1979.

This pamphlet includes summary data from the 1951 through 1979 surveys. The 1947 and 1949 surveys were not tabulated in sufficient detail for inclusion in this pamphlet.

For convenience in comparison with current data, the following notes show which tables of EMPLOYEE BENEFITS 1979 contain current data.

Table 1. Number of Companies in Surveys, by Industry Groups, 1951-79. Department stores were included with trade (wholesale and other retail) from 1951 through 1963. No hospitals submitted data in the 1951 through 1969 surveys. Hospitals were included in the miscellaneous nonmanufacturing industries in 1971 and 1973. Hotels were in the miscellaneous nonmanufacturing industries from 1963 through 1979. This table includes data which appears in Tables 3, 5, and other Tables of EMPLOYEE BENEFITS 1979.

Table 2. Percentage Distribution of Total Employee Benefits, 1951-79. This table contains data computed from Table 1 of EMPLOYEE BENEFITS 1979.

Table 3. Five Levels of Total Employee Benefits, 1951-79. This table contains data from Table 2 of EMPLOYEE BENEFITS 1979.

Table 4. Employee Benefits as Percent of Payroll, by Type of Benefit, 1951-79. This table contains data from Tables 4, 5, and 6 of EMPLOYEE BENEFITS 1979.

Table 5. Percent of Companies Paying Employee Benefits, 1955-79. Data for this table is from Table 15 of EMPLOYEE BENEFITS 1979.

Table 6. Average Benefit Costs as Percent of Payroll for Companies Paying Employee Benefits, 1955-79. Data for this table is from Table 16 of EMPLOYEE BENEFITS 1979.

Table 7. Employee Benefits as Cents per Payroll Hour by Type of Benefit, 1951-79. Data for this table is from Tables 5 and 7 of EMPLOYEE BENEFITS 1979.

Table 8. Employee Benefits as Dollars per Year per Employee, by Type of Benefit, 1951-79. Data for this table appears in Tables 5 and 8 of EMPLOYEE BENEFITS 1979.

Table 9. Total Employee Benefits as Percent of Payroll, by Industry Groups, 1951-79. Data for this table appears in Tables 5, 6, and other Tables of EMPLOYEE BENEFITS 1979.

Table 10. Total Employee Benefits as Cents per Payroll Hour, by Industry Groups, 1951-79. Data for this table appears in Tables 5 and 7 of EMPLOYEE BENEFITS 1979.

Table 11. Total Employee Benefits as Dollars per Year per Employee, by Industry Groups, 1951-79. Data for this table appears in Tables 5 and 8 of EMPLOYEE BENEFITS 1979.

Table 12. Total Employee Benefits as Percent of Payroll, by Region, and by Size of Company, 1951-79. Data for this table appears in Tables 9 and 10 of EMPLOYEE BENEFITS 1979.

Table 13. Pensions as Percent of Payroll for All Companies in Surveys, by Industry Groups, 1951-79. Data for this table is in Table 11 of EMPLOYEE BENEFITS 1979.

Table 14. Pensions as Percent of Payroll for Companies Reporting Pension Payments, 1955-79. Most percentages in this table are somewhat higher than corresponding percentages in Table 13, since companies reporting no pension payments are omitted. Data for this table appears in Tables 11 and 16 of EMPLOYEE BENEFITS 1979.

Table 15. Distribution of Pension Payments as Percent of Payroll, 1951-79. Data for this table appears in, or was computed from, Tables 11, 14, and 16 of EMPLOYEE BENEFITS 1979.

Table 16. Insurance Payments as Percent of Payroll for All Companies in Surveys, 1951-79. Data for this table appears in Tables 12 and 13 of EMPLOYEE BENEFITS 1979.

Table 17. Insurance Payments as Percent of Payroll for Companies Reporting Insurance Payments, 1955-79. Many percentages in this table are somewhat higher than corresponding percentages in Table 16, since companies reporting no insurance payments are omitted. Data for this table appears in Tables 12, 13, and 16 of EMPLOYEE BENEFITS 1979.

Table 18. Distribution of Insurance Payments as Percent of Payroll, 1951-79. Data for this table appears in, or was computed from, Tables 12, 13, 14, and 16 of EMPLOYEE BENEFITS 1979.

Table 19. Payroll Deductions by Type of Deduction, 1955-79. Data for this table appears in, or was computed from, data in Tables 14, 17, and 18 of EMPLOYEE BENEFITS 1979.

Table 20. Wage Data, 1951-79. Data for this table appears in, or was computed from, data in Table 18 of EMPLOYEE BENEFITS 1979.

Table 21. Estimated Employee Benefits, Total United States Economy, by Type of Benefit, 1929-79. These estimates are based upon data from the Chamber surveys, and from United States Department of Commerce data on supplements to wages and salaries. Since this table includes estimates for smaller companies, and for industries not covered in Chamber surveys, both groups having relatively low benefits, percentages in this table are somewhat lower than percentages from the Chamber surveys shown in Tables 2 through 18 of this report. Department of Commerce wage and salary data in this table are those available when the estimates were made, and do not reflect later revisions. Data for this table is from Table 21 of EMPLOYEE BENEFITS 1979.

Table 22. Estimated Total Employee Benefits, Total United States Economy, by Industry Groups, 1955-79. These estimates are based upon data from the Chamber surveys and from United States Department of Commerce data on supplements to wages and salaries. Department of Commerce wage and salary data used in computing percentages in this table were those available when the estimates were made, and do not reflect later revisions. Data for this table is from Table 20 of EMPLOYEE BENEFITS 1979.

DEPARTMENT OF COMMERCE SUPPLEMENTS

The United States Department of Commerce, in its national income statistics, publishes supplements to wages and salaries, which approximate the Chamber employee benefits data outside payroll (Items B, C, and F of the Chamber questionnaire).

The supplements include directors' fees, pay of the military reserves, government payment to enemy prisoners of war, war-risk life and injury claims, jury and witness fees, compensation of prison inmates, and marriage fees to justices of the peace, none of which are included in the Chamber survey of employee benefits.

The supplements do not include payments for time not worked (Items D and E of the Chamber questionnaire), discounts on goods and services purchased from the company by employees, employee meals furnished free, contributions to employee thrift plans, or employee education expenditures, all of which are included in the Chamber employee benefits.

The supplements combine pension and profit-sharing payments.

Supplements are defined in the Department of Commerce publication NATIONAL INCOME, 1954 edition.

Tables 23, 24, and 25 of this report include supplements data. The sources of supplement data are:

THE NATIONAL INCOME AND PRODUCT ACCOUNTS OF THE UNITED STATES, 1929-65:
- Table 1.10.—National Income by Type of Income: Annually.
- Table 3.8.—Contributions for Social Insurance: Annually.
- Table 6.2.—Wages and Salaries by Industry: Annually.
- Table 6.5.—Compensation of Employees by Industry: Annually.
- Table 6.7.—Supplements to Wages and Salaries by Industry Division: Annually.

THE NATIONAL INCOME AND PRODUCT ACCOUNTS OF THE UNITED STATES, 1929-74 and THE NATIONAL INCOME AND PRODUCT ACCOUNTS OF THE UNITED STATES, 1929-76.
- Table 3.11.—Contributions for Social Insurance: Annually.
- Table 6.5.—Compensation of Employees by Industry: Annually.
- Table 6.6.—Wages and Salaries by Industry: Annually.
- Table 6.12.—Employer Contributions for Social Insurancy by Industry: Annually.
- Table 6.13.—Other Labor Income by Industry and by Type: Annually.

Data not available in printed form is from computer print outs of the Department of Commerce.

Table 23. Supplements to Wages and Salaries, 1929-79. Data obtained from above sources.

Table 24. Supplements as Percent of Total Wages and Salaries, by Type of Supplement, 1929-79. Computed from above sources.

Table 25. Supplements as Percent of Wages and Salaries, by Industry Groups, 1929-79. Computed from above sources.

Table 1.

Number of Companies in Surveys, by Industry Groups, 1951-79.

Industry group	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total, all industries	736	940	1,000	1,020	1,064	1,120	1,150	1,181	1,150	1,115	885	742	761	748	858	922
Total, all manufacturing	435	594	601	656	692	746	771	775	717	666	533	437	445	439	497	523
Manufacture of:																
Food, beverages, and tobacco	39	43	40	48	47	62	62	62	50	49	35	21	26	28	28	34
Textile products and apparel	38	52	44	45	41	58	52	48	30	32	29	25	25	24	26	29
Pulp, paper, lumber, and furniture	38	55	71	64	66	74	74	69	71	73	45	41	46	32	33	27
Printing and publishing	9	10	12	12	16	19	28	31	29	38	23	18	15	22	32	31
Chemicals and allied products	42	50	50	48	62	59	56	56	45	45	39	36	30	36	30	30
Petroleum industry	17	18	19	16	18	15	18	14	12	11	12	9	9	13	11	12
Rubber, leather, and plastic products	17	26	23	24	26	20	24	30	32	22	12	12	15	9	24	24
Stone, clay, and glass products	16	17	21	33	39	40	43	25	29	28	32	19	24	23	20	23
Primary metal industries	33	42	50	56	55	60	64	71	61	60	40	35	32	30	36	34
Fabricated metal products (excluding machinery and transportation equipment)	30	64	68	79	83	86	88	96	104	81	70	51	52	43	58	69
Machinery (excluding electrical)	62	94	86	106	109	113	117	101	98	100	90	67	64	68	81	88
Electrical machinery, equipment, and supplies	34	50	40	48	52	66	55	64	70	48	46	50	47	45	56	57
Transportation equipment	41	51	52	52	53	44	46	54	40	42	36	30	35	34	28	31
Instruments and miscellaneous manufacturing industries	19	22	25	25	25	30	44	54	46	37	24	23	25	32	34	34
Total, all nonmanufacturing	301	346	399	364	372	374	379	406	433	449	352	305	316	309	361	399
Public utilities (electric, gas, water, telephone, etc.)	100	107	103	114	123	120	132	146	136	155	134	119	116	110	113	113
Department stores	...	...	...	...	...	...	...	18	25	19	17	13	20	9	11	7
Trade (wholesale and other retail)	37	37	29	26	34	38	49	25	31	34	25	21	18	27	27	25
Banks, finance companies, and trust companies	91	119	104	96	93	88	93	91	105	104	69	57	50	40	41	47
Insurance companies	59	67	64	57	64	72	64	69	73	73	61	61	53	51	64	70
Hospitals	...	...	...	...	...	...	...	...	...	...	...	...	23	39	65	67
Hotels	6	9	88	55	33	28	...	...	...	...	...	...	...	...	...	...
Miscellaneous nonmanufacturing industries	8	7	11	16	25	28	41	57	63	64	46	34	36	33	40	70

... Data not shown separately for this industry group.

Table 2.

Percentage Distribution of Total Employee Benefits, 1951-79.

Item	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total employee benefits as percent of payroll:																
Under 10.0%	7	6	5	3	1	1	*	1	1	*	*	0	0	0	0	0
10.0-19.9	56	56	50	41	37	27	23	25	17	14	7	6	3	3	2	3
20.0-29.9	29	30	34	44	47	51	55	53	53	50	42	31	25	19	21	20
30.0-39.9	7	6	9	9	12	17	18	18	24	30	39	47	45	44	44	45
40.0-49.9	1	2	2	2	2	3	3	2	4	5	10	12	21	26	25	25
50.0-59.9	*	*	*	1	1	1	1	1	1	1	2	3	4	6	6	6
60.0 and over	*	*	*	*	*	*	*	*	*	*	*	1	2	2	2	1
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Total employee benefits as cents per payroll hour:																
Under 50.0¢	93	88	77	60	43	31	21	19	12	7	2	*	*	*	*	*
50.0-99.9	7	11	22	38	54	64	70	67	63	49	27	13	7	4	2	2
100.0-149.9	*	1	1	2	3	4	8	13	22	36	48	37	21	10	10	7
150.0-199.9	0	*	*	*	*	1	1	1	3	7	20	32	30	23	18	16
200.0-249.9	0	0	*	0	*	*	*	*	*	1	3	14	23	27	27	24
250.0-299.9	0	0	0	0	0	*	*	*	*	*	*	4	12	19	18	19
300.0-349.9	0	0	0	0	0	0	*	0	*	*	*	*	5	10	14	14
350.0-399.9	0	0	0	0	0	0	0	0	0	0	*	*	2	4	7	9
400.0-449.9	0	0	0	0	0	0	0	0	0	0	0	0	*	3	3	5
450.0-499.9	0	0	0	0	0	0	0	0	0	0	0	0	0	*	1	2
500.0 and over	0	0	0	0	0	0	0	0	0	0	0	0	0	*	*	2
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Total employee benefits as dollars per year per employee:																
Under $1,000	91	86	74	56	38	27	18	17	11	7	2	11	6	*	*	*
1,000-1,999	9	14	26	43	58	66	71	67	61	44	24	34	19	4	*	*
2,000-2,999	*	*	*	1	4	6	10	15	25	39	47	33	31	10	11	8
3,000-3,999	*	*	*	*	*	1	1	1	3	9	22	17	23	20	17	15
4,000-4,999	0	0	0	0	*	*	*	*	*	1	4	4	13	27	25	21
5,000-5,999	0	0	0	0	0	0	*	*	*	*	1	1	6	21	19	21
6,000-6,999	0	0	0	0	0	0	0	0	0	0	*	*	2	10	13	14
7,000-7,999	0	0	0	0	0	0	0	0	0	*	*	*	*	7	8	10
8,000-8,999	0	0	0	0	0	0	0	0	0	0	0	*	*	1	4	5
9,000 and over	0	0	0	0	0	0	0	0	0	0	0	0	*	*	3	6
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

*Less than 0.5%.

Table 3.

Five Levels of Total Employee Benefits, 1951-79.

Item	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total employee benefits as percent of payroll:																
10% of firms paid more than	28.4	29.1	30.6	31.0	32.2	34.0	34.1	35.1	35.8	37.7	41.3	43.4	46.6	48.7	48.7	48.1
25% of firms paid more than	22.2	23.1	24.5	25.6	26.6	28.8	29.3	29.1	31.2	32.7	35.7	37.6	40.4	42.3	42.1	41.8
50% of firms paid more than	17.4	18.2	19.2	21.0	21.9	23.9	24.4	24.1	25.6	27.1	30.3	32.4	34.6	36.4	35.9	35.9
75% of firms paid more than	13.5	14.1	15.1	16.6	18.0	19.6	20.4	19.7	21.4	22.7	25.2	27.1	29.2	30.9	30.9	30.9
90% of firms paid more than	10.7	11.0	11.6	13.3	14.4	16.8	17.2	16.3	18.1	18.6	20.5	22.7	24.6	25.5	25.6	25.2
Mean or average payment	18.7	19.2	20.3	21.8	22.8	24.9	25.6	24.7	26.6	27.9	30.8	32.7	35.4	36.7	36.9	36.6
Total employee benefits as cents per payroll hour:																
10% of firms paid more than	46.4	52.6	62.6	72.0	80.7	89.9	98.5	108.3	124.4	145.9	175.6	212.6	261.8	331.3	360.6	394.5
25% of firms paid more than	38.4	41.9	48.3	58.3	66.1	74.8	81.3	87.2	96.8	121.6	148.2	185.8	234.8	274.3	300.5	321.0
50% of firms paid more than	29.1	32.6	38.2	45.8	53.7	59.9	65.9	69.0	79.6	95.2	118.4	150.1	186.7	220.0	238.0	251.3
75% of firms paid more than	21.5	24.5	27.6	34.8	41.5	46.1	52.2	54.3	61.6	74.0	94.1	119.8	144.8	176.6	188.1	199.2
90% of firms paid more than	16.8	18.5	17.8	22.8	30.8	33.8	39.8	40.4	47.3	54.7	72.8	92.9	110.4	134.6	139.5	154.7
Mean or average payment	31.5	34.6	39.2	47.4	54.8	61.6	68.8	71.5	82.2	98.3	122.3	154.1	193.2	226.4	247.1	267.6
Total employee benefits as dollars per year per employee:																
10% of firms paid more than	981	1,093	1,297	1,478	1,651	1,854	2,019	2,181	2,565	3,018	3,653	4,673	5,810	6,799	7,546	8,161
25% of firms paid more than	800	882	1,016	1,186	1,355	1,548	1,680	1,818	2,090	2,512	3,066	4,092	4,770	5,619	6,205	6,669
50% of firms paid more than	608	685	803	956	1,091	1,237	1,384	1,456	1,656	1,985	2,463	3,147	3,785	4,578	4,917	5,248
75% of firms paid more than	453	518	588	729	874	967	1,082	1,147	1,296	1,566	1,976	2,534	3,000	3,640	3,889	4,097
90% of firms paid more than	342	397	383	478	633	697	835	848	983	1,204	1,491	1,961	2,260	2,756	2,954	3,136
Mean or average payment	644	720	819	981	1,132	1,254	1,431	1,502	1,719	2,052	2,544	3,230	3,984	4,692	5,138	5,560

Table 4.

Employee Benefits as Percent of Payroll, by Type of Benefit, 1951-79.

Type of benefit	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total employee benefits as percent of payroll	18.7	19.2	20.3	21.8	22.8	24.9	25.6	24.7	26.6	27.9	30.8	32.7	35.4	36.7	36.9	36.6
1. Legally required payments (employer's share only)	3.5	3.2	3.6	3.9	4.2	5.1	5.6	4.9	5.9	6.4	6.3	7.5	8.0	8.5	9.0	9.0
a. Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	1.4	1.3	1.8	2.1	2.3	2.7	3.0	2.7	3.9	4.6	4.5	5.3	5.7	5.4	5.6	5.8
b. Unemployment Compensation	1.4	1.1	1.0	1.0	1.1	1.5	1.7	1.4	1.0	0.8	0.7	1.2	1.0	1.5	1.7	1.5
c. Workers' compensation (including estimated cost of self-insured)	0.6	0.7	0.7	0.7	0.7	0.8	0.8	0.7	0.8	0.9	1.0	0.9	1.2	1.5	1.8	1.7
d. Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, state sickness benefits insurance, etc.**	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	*
2. Pension, insurance, and other agreed-upon payments (employer's share only)	5.4	5.9	6.3	6.8	7.2	7.9	7.8	7.7	8.0	8.3	10.0	10.5	11.6	12.7	12.2	12.1
a. Pension plan premiums and pension payments not covered by insurance-type plan (net)	3.6	3.8	3.8	4.1	4.3	4.2	3.9	3.7	4.0	4.2	4.8	5.1	5.5	5.9	5.6	5.4
b. Life insurance premiums; death benefits; hospital surgical, medical, and major medical insurance premiums, etc. (net)	1.4	1.8	2.0	2.2	2.3	2.7	2.9	3.0	3.2	3.5	4.5	4.6	5.2	5.9	5.6	5.7
c. Salary continuation or long-term disability	...	...	...	...	...	...	...	...	...	...	...	...	0.2	0.2	0.3	0.3
d. Dental insurance premiums	...	...	...	...	...	...	...	...	...	...	...	...	0.1	0.2	0.2	0.3
e. Contributions to privately financed unemployment benefit funds	...	...	*	0.1	0.1	0.1	0.1	0.1	0.1	*	*	*	...	...	...	...
f. Separation or termination pay allowances	*	*	*	*	*	0.1	0.1	0.1	0.1	0.1	0.1	0.1	...	...	...	...
g. Discounts on goods and services purchased from company by employees	0.2	0.1	0.2	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.2	0.2	0.1	0.1	0.1
h. Employee meals furnished by company	...	...	...	...	...	0.4	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1
i. Miscellaneous payments (compensation payments in excess of legal requirements, separation or termination pay allowances, moving expenses, etc.)	0.2	0.2	0.3	0.3	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.3	0.2	0.2	0.2	0.2
3. Paid rest periods, lunch periods, wash-up time, travel time, clothes-change time, get-ready time, etc.	1.9	2.0	2.2	2.3	2.4	2.6	2.7	2.5	2.7	2.9	3.4	3.5	3.6	3.5	3.6	3.5
4. Payments for time not worked	6.0	6.2	6.3	6.9	7.2	7.6	7.8	7.7	7.9	8.3	9.2	9.2	10.1	9.8	9.7	9.5
a. Paid vacations and payments in lieu of vacation	3.2	3.3	3.5	3.8	4.0	4.2	4.3	4.1	4.2	4.4	4.8	4.7	5.2	5.0	4.9	4.7
b. Payments for holidays not worked	2.0	2.1	2.0	2.3	2.3	2.5	2.6	2.6	2.6	2.7	3.0	3.0	3.3	3.2	3.2	3.2
c. Paid sick leave	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7	0.8	0.9	1.0	1.1	1.2	1.2	1.2	1.2
d. Payments for State or National Guard duty, jury, witness, and voting pay allowances; payments for time lost due to death in family or other personal reasons, etc.	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4
5. Other items	1.9	1.9	1.9	1.9	1.8	1.7	1.7	1.9	2.1	2.0	1.9	2.0	2.1	2.2	2.4	2.5
a. Profit-sharing payments	0.7	0.6	0.7	0.8	0.9	0.8	0.9	1.1	1.2	1.2	1.0	1.1	1.1	1.1	1.4	1.4
b. Contributions to employee thrift plans	...	...	...	...	...	...	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.4	0.3	0.3
c. Christmas or other special bonuses, service awards, suggestion awards, etc.	1.0	1.0	1.0	0.8	0.7	0.7	0.5	0.4	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4
d. Employee education expenditures (tuition refunds, etc.)	...	...	...	...	...	*	*	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2
e. Special wage payments ordered by courts, payments to union stewards, etc.	0.2	0.3	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2

... Data not requested for this benefit.
**Less than 0.05%.*
***Figure shown is considerably less than legal rate, because most reporting companies had only a small proportion of employees covered by tax.*

Chart 1.

Total Employee Benefits as Percent of Payroll, 1951-79.

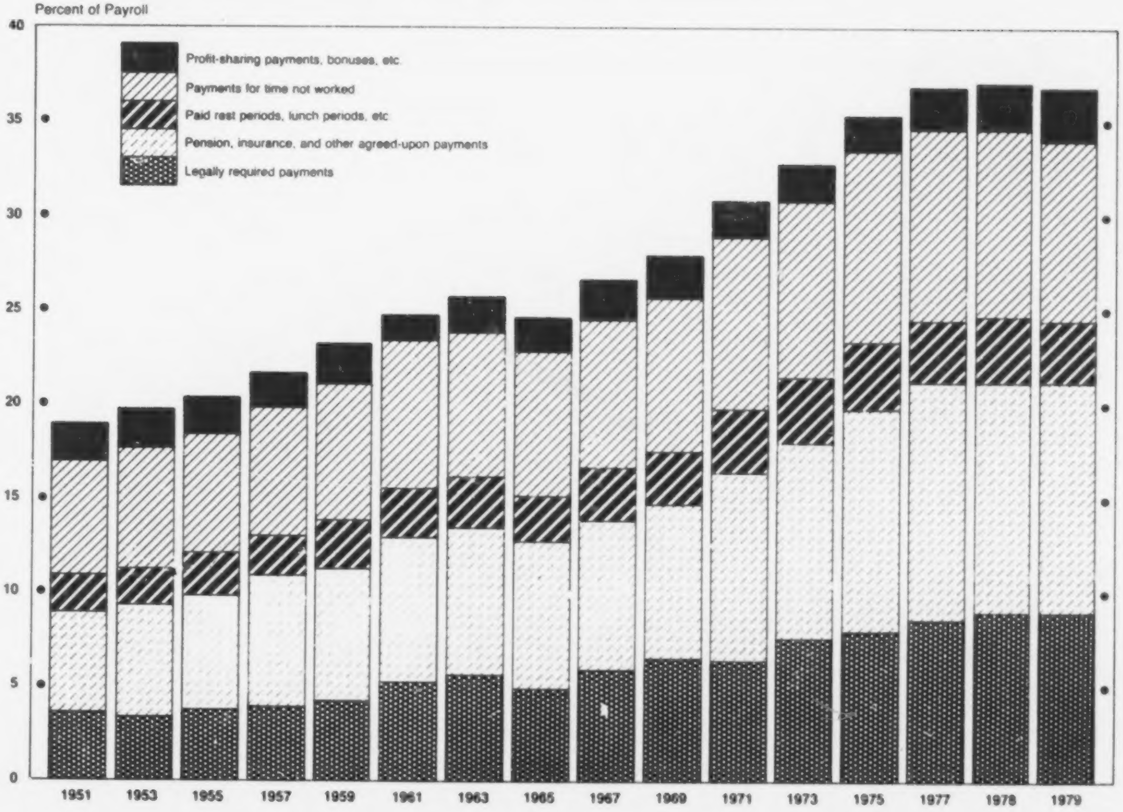


Chart 2.

Employee Benefits as Percent of Payroll, by Type of Benefit, 1951-79.

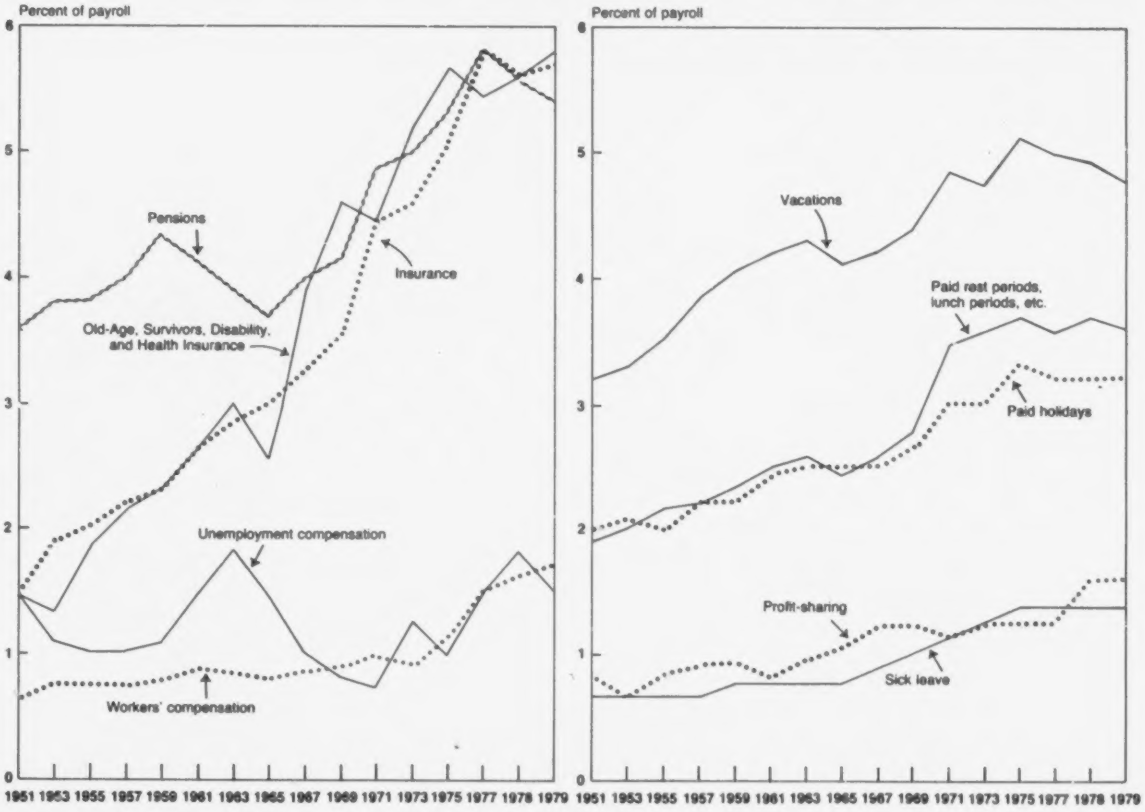


Table 5.

Percent of Companies Paying Employee Benefits, 1955-79.

Type of benefit	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
1. Legally required payments (employer's share only):														
a. Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	99	100	100	100	100	99	99	99	100	100	100	100	100	100
b. Unemployment Compensation	99	99	99	99	99	98	98	99	97	98	98	98	99	99
c. Workers' compensation (including estimated cost of self-insured)	93	93	94	95	96	91	90	95	95	93	94	96	96	96
d. Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, state sickness benefits insurance, etc.	8	10	14	12	8	9	9	10	10	10	10	11	9	9
2. Pension, insurance, and other agreed-upon payments (employer's share only):														
a. Pension plan premiums and pension payments not covered by insurance-type plan (net)	75	81	86	86	85	85	85	86	89	90	89	91	89	86
b. Life insurance premiums; death benefits; hospital surgical, medical, and major medical insurance premiums, etc. (net)	96	97	98	98	99	99	98	99	99	99	100	100	99	100
c. Salary continuation or long-term disability	...	...	...	...	...	...	...	...	...	...	35	42	48	49
d. Dental insurance premiums	...	...	...	...	...	...	...	...	...	...	12	19	27	33
e. Contributions to privately financed unemployment benefit funds	2	8	8	8	6	6	5	4	4	4	...	...	...	...
f. Separation or termination pay allowances	12	11	20	17	10	13	15	14	16	16	...	...	...	...
g. Discounts on goods and services purchased from company by employees	15	14	17	15	13	15	13	15	16	16	16	17	16	15
h. Employee meals furnished by company	...	...	...	21	18	20	18	22	20	25	22	22	21	18
i. Miscellaneous payments (compensation payments in excess of legal requirements, separation or termination pay allowances, moving expenses, etc.)	19	19	26	22	18	20	22	23	29	27	28	26	26	27
3. Paid rest periods, lunch periods, wash-up time, travel time, clothes-change time, get-ready time, etc.	57	57	62	63	64	62	72	78	77	81	83	81	81	79
4. Payments for time not worked:														
a. Paid vacations and payments in lieu of vacation	98	97	98	97	98	96	96	98	97	98	98	97	98	96
b. Payments for holidays not worked	93	95	93	95	95	96	97	98	98	98	99	97	98	95
c. Paid sick leave	56	49	54	54	54	57	59	65	67	73	76	76	77	78
d. Payments for State or National Guard duty, jury, witness, and voting pay allowances; payments for time lost due to death in family or other personal reasons, etc.	37	40	60	53	41	48	51	63	67	71	75	76	73	73
5. Other items:														
a. Profit-sharing payments	13	14	15	17	21	19	21	22	19	20	20	20	21	21
b. Contributions to employee thrift plans	...	...	...	...	5	7	8	10	13	16	18	20	18	20
c. Christmas or other special bonuses, service awards, suggestion awards, etc.	50	46	53	43	36	37	43	43	41	43	45	46	46	45
d. Employee education expenditures (tuition refunds, etc.)	...	...	...	16	15	21	24	34	33	37	40	40	46	48
e. Special wage payments ordered by courts, payments to union stewards, etc.	31	32	42	37	25	30	29	28	34	34	35	36	34	32

... Data not requested for this benefit

Chart 3.

Percent of Companies Paying Employee Benefits, by Type of Benefit, 1955-79.

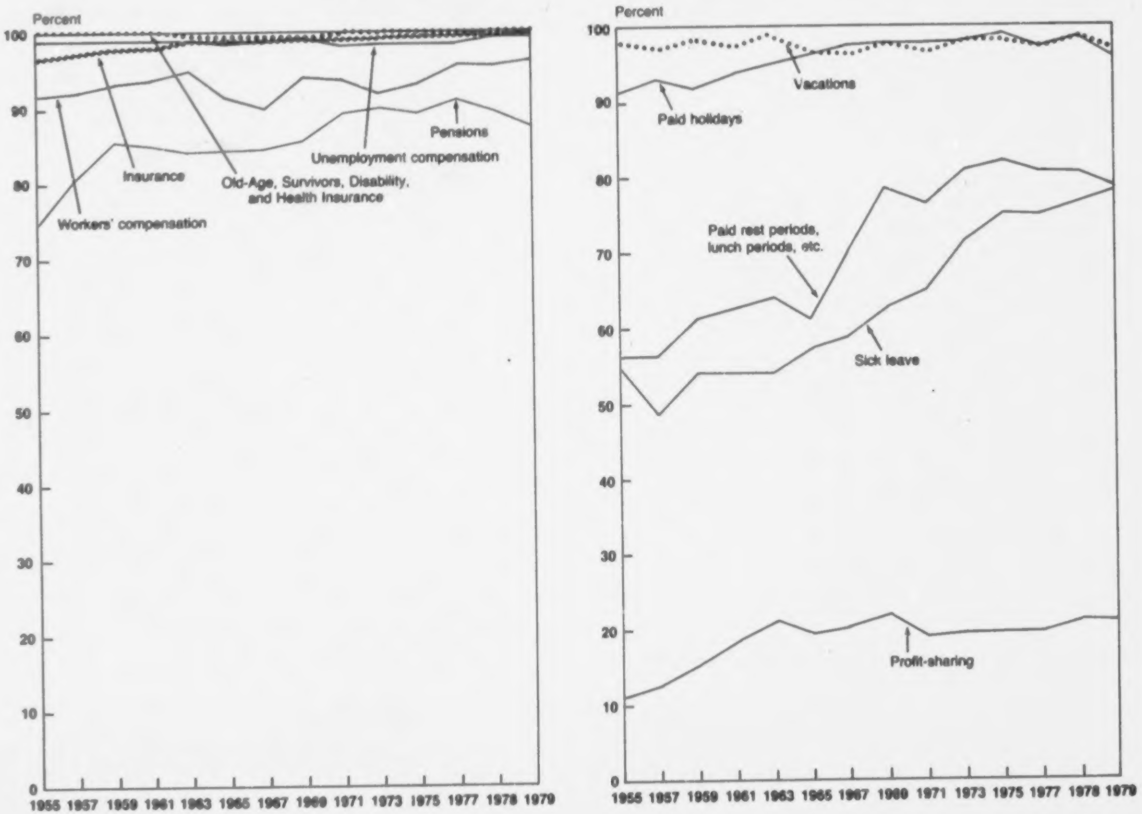


Table 6.

Average Benefit Costs as Percent of Payroll for Companies Paying Employee Benefits, 1955-79.

Type of benefit	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
1. Legally required payments (employer's share only):														
a. Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	1.8	2.1	2.3	2.7	3.0	2.7	3.9	4.6	4.5	5.3	5.7	5.4	5.6	5.8
b. Unemployment Compensation	1.0	1.0	1.1	1.5	1.7	1.4	1.0	0.8	0.7	1.2	1.0	1.5	1.7	1.5
c. Workers' compensation (including estimated cost of self-insured)	0.7	0.8	0.7	0.8	0.8	0.8	0.9	1.0	1.0	1.0	1.3	1.5	1.7	1.8
d. Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, state sickness benefits insurance, etc.*	0.5	0.7	0.5	0.6	1.5	1.3	1.6	1.1	1.0	1.1	1.1	1.1	0.7	0.5
2. Pension, insurance, and other agreed-upon payments (employer's share only):														
a. Pension plan premiums and pension payments not covered by insurance-type plan (net)	5.1	5.1	5.0	4.9	4.6	4.4	4.8	4.8	5.5	5.7	6.2	6.5	6.3	6.3
b. Life insurance premiums; death benefits; hospital surgical, medical, and major medical insurance premiums, etc. (net)	2.1	2.3	2.3	2.8	2.9	3.0	3.2	3.6	4.5	4.7	5.2	5.9	5.6	5.7
c. Salary continuation or long-term disability	...	...	...	...	...	—	...	...	...	...	0.6	0.6	0.6	0.6
d. Dental insurance premiums	...	...	...	...	...	...	...	...	...	...	0.8	0.9	0.8	0.8
e. Contributions to privately financed unemployment benefit funds	0.6	1.4	1.1	1.2	1.3	1.3	1.0	0.9	1.2	0.9	...	...	...	...
f. Separation or termination pay allowances	0.2	0.3	0.2	0.3	0.5	0.5	0.3	0.5	0.4	0.4	...	...	...	...
g. Discounts on goods and services purchased from company by employees	1.0	0.8	0.7	0.8	1.1	0.9	1.1	0.8	0.9	1.0	1.0	0.7	0.7	0.6
h. Employee meals furnished by company	...	...	—	1.9	1.3	0.9	1.1	0.9	0.8	0.9	0.9	0.8	0.8	0.8
i. Miscellaneous payments (compensation payments in excess of legal requirements, separation or termination pay allowances, moving expenses, etc.)	1.6	1.6	1.4	1.2	1.2	1.1	0.8	0.9	0.8	1.0	0.8	0.8	0.9	0.9
3. Paid rest periods, lunch periods, wash-up time, travel time, clothes-change time, get-ready time, etc.	3.9	4.0	3.9	4.1	4.2	4.0	3.8	4.0	4.4	4.3	4.4	4.3	4.4	4.5
4. Payments for time not worked:														
a. Paid vacations and payments in lieu of vacation	3.5	3.9	4.0	4.3	4.4	4.3	4.4	4.5	5.0	4.8	5.3	5.1	5.0	4.9
b. Payments for holidays not worked	2.2	2.4	2.5	2.6	2.7	2.7	2.7	2.8	3.0	3.1	3.4	3.3	3.3	3.3
c. Paid sick leave	1.1	1.2	1.2	1.3	1.3	1.3	1.3	1.4	1.5	1.5	3.6	1.6	1.6	1.6
d. Payments for State or National Guard duty; jury, witness, and voting pay allowances; payments for time lost due to death in family or other personal reasons, etc.	0.5	0.5	0.3	0.4	0.5	0.5	0.5	0.5	0.5	0.6	0.6	0.5	0.5	0.5
5. Other items:														
a. Profit-sharing payments	5.5	5.4	5.6	4.7	3.9	5.5	5.7	5.2	5.5	5.7	5.5	5.5	6.6	6.7
b. Contributions to employee thrift plans	...	...	...	...	1.7	1.6	1.5	1.6	1.5	1.4	1.5	1.9	1.8	1.4
c. Christmas or other special bonuses, service awards, suggestion awards, etc.	2.0	1.7	1.2	1.4	1.4	1.2	1.1	1.1	1.0	0.9	0.9	0.9	0.8	0.9
d. Employee education expenditures (tuition refunds, etc.)	...	...	...	0.2	0.2	0.3	0.3	0.2	0.3	0.2	0.3	0.3	0.3	0.3
e. Special wage payments ordered by courts, payments to union stewards, etc.	0.8	1.0	0.5	0.5	0.6	0.5	0.6	0.5	0.6	0.5	0.5	0.5	0.5	0.6

... Data not requested for this benefit.

**Figure shown is considerably less than legal rate, because most reporting companies had only a small proportion of employees covered by tax.*

Table 7.

Employee Benefits as Cents per Payroll Hour, by Type of Benefit, 1951-79.

Type of benefit	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total employee benefits as cents per payroll hour	31.5	34.6	39.2	47.4	54.8	61.6	68.8	71.5	82.2	98.3	122.3	154.1	193.2	226.4	247.1	267.6
1. Legally required payments (employer's share only)	5.8	5.8	6.9	8.4	10.0	12.4	15.2	14.2	18.3	22.3	25.2	35.6	43.8	52.4	60.0	65.8
a. Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	2.3	2.4	3.5	4.4	5.4	6.7	8.1	7.8	12.2	16.0	17.9	25.1	30.9	33.4	37.6	42.3
b. Unemployment Compensation	2.4	2.0	1.9	2.3	2.6	3.7	4.6	3.9	3.1	2.7	2.9	5.6	5.5	9.3	11.2	11.0
c. Workers' compensation (including estimated cost of self-insured)	1.0	1.3	1.4	1.6	1.7	1.7	2.2	2.1	2.5	3.2	4.0	4.4	6.8	9.0	10.8	12.2
d. Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, state sickness benefits insurance, etc.**	0.1	0.1	0.1	0.1	0.3	0.3	0.3	0.4	0.5	0.4	0.4	0.5	0.6	0.7	0.4	0.3
2. Pension, insurance, and other agreed-upon payments (employer's share only)	9.0	10.7	12.2	14.9	17.3	19.8	20.9	22.3	24.7	29.4	39.8	49.1	63.2	79.0	81.6	88.7
a. Pension plan premiums and pension payments not covered by insurance-type plan (net)	6.0	6.8	7.3	8.9	10.2	10.4	10.5	10.8	12.5	14.7	19.4	24.0	30.1	36.7	37.4	39.7
b. Life insurance premiums; death benefits; hospital surgical, medical, and major medical insurance premiums, etc. (net)	2.3	3.2	3.8	4.8	5.5	6.7	7.8	8.7	10.0	12.5	17.8	21.8	28.3	36.7	37.2	41.5
c. Salary continuation or long-term disability	...	...	...	...	...	...	...	...	...	...	...	...	1.1	1.5	2.0	2.1
d. Dental insurance premiums	...	...	...	...	...	...	...	...	...	...	...	...	0.5	1.0	1.5	1.9
e. Contributions to privately financed unemployment benefit funds	...	...	*	0.2	0.2	0.3	0.2	0.2	0.2	0.1	0.2	0.1	...	...	...	...
f. Separation or termination pay allowances	0.1	0.1	0.1	0.1	0.1	0.2	0.3	0.2	0.2	0.3	0.3	0.3	...	...	...	...
g. Discounts on goods and services purchased from company by employees	0.3	0.2	0.4	0.2	0.3	0.4	0.5	0.6	0.6	0.4	0.6	0.7	0.9	0.8	0.7	0.7
h. Employee meals furnished by company	...	...	...	...	...	1.0	0.8	0.8	0.8	0.7	0.6	1.0	1.0	1.1	1.2	1.1
i. Miscellaneous payments (compensation payments in excess of legal requirements, separation or termination pay allowances, moving expenses, etc.)	0.3	0.4	0.6	0.7	1.0	0.8	0.8	1.0	0.6	0.7	0.9	1.2	1.3	1.2	1.6	1.7
3. Paid rest periods, lunch periods, wash-up time, travel time, clothes-change time, get-ready time, etc.	3.2	3.6	4.2	5.0	5.8	6.4	7.2	7.2	8.5	10.3	13.4	16.3	19.7	21.7	24.3	26.0
4. Payments for time not worked	10.3	11.2	12.2	15.0	17.3	18.8	20.9	22.4	24.3	29.1	36.4	43.7	55.1	60.0	65.4	69.0
a. Paid vacations and payments in lieu of vacation	5.5	6.0	6.8	8.3	9.6	10.6	11.5	12.0	12.9	15.3	19.3	22.2	28.1	30.7	32.9	34.1
b. Payments for holidays not worked	3.4	3.7	3.9	5.0	5.5	6.0	7.0	7.6	8.0	9.6	11.7	14.1	18.2	19.5	21.7	23.2
c. Paid sick leave	1.0	1.1	1.1	1.3	1.7	1.7	1.9	2.1	2.5	3.1	3.9	5.3	6.5	7.5	8.3	9.0
d. Payments for State or National Guard duty; jury, witness, and voting pay allowances; payments for time lost due to death in family or other personal reasons, etc.	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.7	0.9	1.1	1.5	2.1	2.3	2.3	2.5	2.7
5. Other items	3.2	3.3	3.7	4.1	4.4	4.2	4.6	5.4	6.4	7.2	7.5	9.4	11.4	13.3	15.8	18.1
a. Profit-sharing payments	1.1	1.1	1.4	1.7	2.1	2.0	2.4	3.2	3.7	4.1	4.1	5.3	6.0	6.8	9.1	10.4
b. Contributions to employee thrift plans	...	...	...	...	...	...	0.3	0.3	0.4	0.6	0.8	1.1	1.5	2.3	2.1	2.1
c. Christmas or other special bonuses, service awards, suggestion awards, etc.	1.8	1.8	1.9	1.7	1.7	1.7	1.3	1.3	1.6	1.7	1.7	1.8	2.3	2.4	2.5	3.1
d. Employee education expenditures (tuition refunds, etc.)	...	...	...	...	...	*	0.1	0.2	0.2	0.3	0.4	0.4	0.6	0.7	1.0	1.2
e. Special wage payments ordered by courts, payments to union stewards, etc.	0.3	0.4	0.4	0.7	0.6	0.5	0.5	0.4	0.5	0.5	0.5	0.8	1.0	1.1	1.1	1.3

... Data not requested for this benefit.

***Less than 0.05¢.*

***Figure show is considerably less than legal rate, because most reporting companies had only a small proportion of employees covered by tax.*

Table 8.

Employee Benefits as Dollars per Year per Employee, by Type of Benefit, 1951-79.

Type of benefit	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total employee benefits as dollars per year per employee	644	720	819	981	1,132	1,254	1,431	1,502	1,719	2,052	2,544	3,230	3,984	4,692	5,138	5,560
1. Legally required payments (employer's share only)	119	121	145	170	205	256	313	297	383	468	522	746	903	1,087	1,249	1,368
a. Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	47	50	73	91	112	134	168	163	254	335	372	527	636	693	783	877
b. Unemployment Compensation	49	42	41	44	53	76	95	82	65	57	60	117	114	193	232	229
c. Workers' compensation (including estimated cost of self-insured)	21	27	29	32	35	40	45	45	52	67	82	92	141	186	225	255
d. Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, state sickness benefits insurance, etc.*	2	2	2	3	5	6	5	7	12	9	8	10	12	15	9	7
2. Pension, insurance, and other agreed-upon payments (employer's share only)	185	222	254	310	360	398	436	468	513	612	824	1,032	1,302	1,637	1,697	1,844
a. Pension plan premiums and pension payments not covered by insurance-type plan (net)	122	141	153	185	214	211	218	226	261	306	402	503	620	759	779	825
b. Life insurance premiums; death benefits; hospital surgical, medical, and major medical insurance premiums, etc. (net)	47	67	80	99	114	136	162	184	209	260	369	457	582	760	774	861
c. Salary continuation or long-term disability	...	...	...	...	...	...	...	...	...	...	...	...	23	31	41	46
d. Dental insurance premiums	...	...	...	...	...	...	...	...	...	...	...	...	11	22	30	40
e. Contributions to privately financed unemployment benefit funds	...	...	1	5	5	4	5	4	3	3	4	3	...	...	...	...
f. Separation or termination pay allowances	2	1	1	2	2	5	6	4	3	5	5	6	...	...	...	...
g. Discounts on goods and services purchased from company by employees	6	5	8	5	5	6	11	13	13	9	12	15	18	16	15	14
h. Employee meals furnished by company	...	...	...	...	...	20	17	17	12	15	13	22	21	23	24	23
i. Miscellaneous payments (compensation payments in excess of legal requirements, separation or termination pay allowances, moving expenses, etc.)	8	8	11	14	20	16	17	20	12	14	19	26	27	26	34	35
3. Paid rest periods, lunch periods, wash-up time, travel time, clothes-change time, get-ready time, etc.	64	74	89	104	119	131	151	150	179	214	280	341	408	448	504	539
4. Payments for time not worked	211	233	254	311	358	382	435	471	511	609	755	914	1,137	1,245	1,362	1,434
a. Paid vacations and payments in lieu of vacation	112	125	141	171	199	211	240	252	271	321	400	466	580	636	684	710
b. Payments for holidays not worked	70	78	81	104	114	126	145	161	169	200	244	295	376	405	452	482
c. Paid sick leave	21	22	24	27	35	35	39	43	52	65	81	110	134	156	174	187
d. Payments for State or National Guard duty; jury, witness, and voting pay allowances; payments for time lost due to death in family or other personal reasons, etc.	8	8	8	9	10	10	11	15	19	23	30	43	47	48	52	55
5. Other items	65	70	77	86	90	87	96	116	133	149	163	197	234	275	326	375
a. Profit-sharing payments	23	23	28	36	45	40	50	67	77	85	86	112	123	141	189	216
b. Contributions to employee thrift plans	...	...	...	...	...	...	5	6	8	12	16	22	31	47	43	43
c. Christmas or other special bonuses, service awards, suggestion awards, etc.	36	38	41	36	35	36	28	27	33	35	35	37	47	50	52	64
d. Employee education expenditures (tuition refunds, etc.)	...	...	...	...	...	1	2	6	4	6	8	8	12	15	20	25
e. Special wage payments ordered by courts, payments to union stewards, etc.	6	9	8	14	10	10	11	10	11	11	18	18	21	22	22	27

... Data not requested for this benefit.

**Figure shown is considerably less than legal rate, because most reporting companies had only a small proportion of employees covered by tax.*

Table 9.

Total Employee Benefits as Percent of Payroll, by Industry Groups, 1951-79.

Industry group	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total, all industries	18.7	19.2	20.3	21.8	22.8	24.9	25.6	24.7	26.6	27.9	30.8	32.7	35.4	36.7	36.9	36.6
Total, all manufacturing	16.4	16.8	18.5	20.3	21.6	23.6	24.2	23.6	25.6	27.0	30.6	32.0	36.1	37.3	37.4	37.2
Manufacture of:																
Food, beverages, and tobacco	17.7	20.0	19.7	21.0	21.8	25.4	27.0	27.3	28.0	30.3	33.1	32.6	36.2	36.6	35.0	36.9
Textile products and apparel	14.1	14.5	16.2	17.4	20.0	19.3	20.2	18.9	20.6	22.2	23.6	25.5	27.8	29.0	28.8	29.2
Pulp, paper, lumber, and furniture	14.8	14.3	15.6	17.5	18.8	20.4	21.8	20.4	22.6	23.9	28.4	29.2	32.7	34.0	34.4	36.1
Printing and publishing	15.1	15.5	19.3	20.0	19.9	20.1	20.8	21.1	25.0	25.6	27.4	28.3	32.2	34.9	34.3	35.0
Chemicals and allied products	20.4	20.9	21.8	24.0	25.0	27.6	27.3	27.4	30.9	32.2	34.3	37.0	42.2	43.3	43.4	43.1
Petroleum industry	22.5	24.5	24.3	27.3	28.3	27.0	28.9	28.0	30.8	32.4	35.7	38.2	39.2	40.8	42.3	44.5
Rubber, leather, and plastic products	16.2	15.6	18.2	20.9	22.6	26.1	25.3	25.2	26.4	27.1	30.4	32.5	40.4	38.0	32.6	35.0
Stone, clay, and glass products	14.2	15.8	17.1	19.0	19.4	21.6	22.0	23.2	25.0	27.4	31.3	33.8	35.1	36.5	37.7	36.4
Primary metal industries	14.8	16.7	17.3	20.2	22.4	25.8	25.1	25.0	28.6	29.9	34.8	33.9	40.6	43.3	41.6	43.0
Fabricated metal products (excluding machinery and transportation equipment)	16.2	16.0	19.3	20.5	22.6	25.0	25.2	22.9	24.3	24.6	28.7	32.5	35.1	37.8	38.7	36.4
Machinery (excluding electrical)	15.7	16.0	18.0	20.4	20.9	23.6	23.9	24.1	25.5	26.8	30.1	32.0	36.1	37.5	38.4	36.9
Electrical machinery, equipment, and supplies	16.5	17.0	19.7	20.3	21.5	23.4	24.0	23.7	24.8	26.5	29.6	30.5	35.0	36.6	37.1	36.7
Transportation equipment	15.1	15.0	17.9	21.1	21.3	22.8	23.6	23.1	25.9	28.5	35.0	34.1	39.9	39.1	40.5	39.0
Instruments and miscellaneous manufacturing industries	17.6	17.9	20.4	20.6	22.7	24.1	25.0	23.8	25.3	25.9	31.0	32.2	34.8	34.0	36.4	36.4
Total, all nonmanufacturing	22.2	23.4	22.9	24.2	25.1	27.1	27.8	26.9	28.2	29.3	31.0	33.9	34.4	35.8	36.1	35.7
Public utilities (electric, gas, water, telephone, etc.)	20.6	20.5	22.8	23.5	24.3	25.6	26.3	26.9	28.7	30.3	32.5	34.8	37.5	39.7	40.2	40.6
Department stores	...	...	...	...	...	...	...	23.1	22.8	23.1	24.2	28.1	28.4	32.0	31.5	31.7
Trade (wholesale and other retail)	18.5	17.9	20.1	20.9	20.7	22.2	23.6	24.1	23.3	21.7	24.5	28.8	28.2	30.7	28.9	28.8
Banks, finance companies, and trust companies	26.4	28.7	30.5	31.7	31.7	33.5	32.9	32.1	32.5	33.9	35.6	37.2	37.3	39.9	39.2	39.4
Insurance companies	21.7	22.8	25.5	26.7	27.1	27.7	29.3	27.0	29.0	30.3	31.8	35.2	35.2	36.5	38.2	38.3
Hospitals	...	...	...	...	...	...	...	...	...	...	...	...	24.0	25.7	27.1	28.2
Hotels	15.6	17.7	13.0	13.4	13.8	20.4	...	...	...	...	...	...	...	...	...	...
Miscellaneous nonmanufacturing industries	17.3	21.4	25.1	25.4	25.1	24.4	23.7	21.2	23.6	25.1	25.4	27.5	32.2	33.7	38.6	34.4

... *Data not shown separately for this industry group.*

Table 10.

Total Employee Benefits as Cents per Payroll Hour, by Industry Groups, 1951-79.

Industry group	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total, all industries	31.5	34.6	39.2	47.4	54.8	61.6	68.8	71.5	82.2	98.3	122.3	154.1	193.2	226.4	247.1	267.6
Total, all manufacturing	28.9	31.5	37.7	44.9	53.0	59.5	65.3	67.6	78.3	93.0	118.8	146.2	191.3	224.5	246.1	267.1
Manufacture of:																
Food, beverages, and tobacco	29.5	35.5	38.7	44.6	50.3	61.5	71.9	77.9	80.8	101.5	126.3	142.6	184.8	205.8	222.8	247.8
Textile products and apparel	21.5	22.0	26.0	30.3	38.0	36.8	41.5	38.7	45.5	58.4	72.0	87.3	108.2	124.6	132.7	150.4
Pulp, paper, lumber, and furniture	24.9	25.9	30.5	36.3	42.3	46.9	54.8	57.2	66.3	74.9	104.0	124.9	163.7	194.3	216.9	242.8
Printing and publishing	30.6	35.0	45.4	51.3	53.6	56.4	62.4	68.3	87.3	98.5	113.6	138.8	177.8	212.1	236.0	257.2
Chemicals and allied products	34.2	39.7	45.2	52.9	61.6	70.8	76.0	79.9	98.7	115.8	142.3	176.5	239.5	281.0	308.0	340.1
Petroleum industry	46.4	56.0	61.0	78.2	83.6	81.2	90.4	99.7	118.2	139.2	164.1	200.8	248.9	306.8	361.0	432.7
Rubber, leather, and plastic products	26.1	27.3	34.1	44.8	51.0	63.7	63.1	65.8	76.2	84.4	108.2	144.9	190.1	209.0	194.9	223.1
Stone, clay, and glass products	22.8	27.8	32.2	39.4	46.7	55.6	59.3	65.3	70.6	91.1	117.3	145.0	179.7	208.8	233.5	246.9
Primary metal industries	26.1	33.6	37.0	47.2	60.2	69.4	72.7	77.2	94.2	109.2	137.0	162.5	232.7	281.5	285.9	314.4
Fabricated metal products (excluding machinery and transportation equipment)	28.4	30.6	39.3	46.3	55.3	61.5	67.4	65.7	75.0	84.2	110.5	150.7	182.7	218.2	244.3	248.3
Machinery (excluding electrical)	29.1	31.3	39.3	51.1	54.7	63.3	67.1	72.6	80.0	95.5	120.9	151.9	197.4	234.1	260.9	276.0
Electrical machinery, equipment, and supplies	27.4	31.2	38.1	43.4	51.3	58.6	64.2	63.1	72.7	90.1	116.5	138.4	186.9	218.0	244.5	269.3
Transportation equipment	27.9	30.1	38.3	53.7	56.1	63.4	70.7	70.1	85.2	102.8	138.7	163.4	224.0	252.5	299.2	315.7
Instruments and miscellaneous manufacturing industries	27.1	30.5	38.5	45.0	52.7	62.0	67.8	63.8	72.8	85.0	116.4	143.6	177.1	189.1	228.7	250.8
Total, all nonmanufacturing	35.3	40.0	41.4	50.8	58.1	65.6	74.6	79.0	88.6	106.1	127.8	165.4	195.8	229.1	247.4	268.2
Public utilities (electric, gas, water, telephone, etc.)	36.5	40.3	48.3	55.4	63.7	71.4	77.7	86.2	100.5	121.1	144.3	185.9	239.2	286.8	319.3	356.4
Department stores	...	...	...	...	...	...	...	46.6	49.3	56.1	66.6	97.3	108.5	134.7	141.6	156.0
Trade (wholesale and other retail)	23.9	26.0	32.8	40.4	43.0	50.2	57.4	56.7	60.4	62.4	88.8	113.4	134.1	167.7	179.8	184.7
Banks, finance companies, and trust companies	42.0	47.4	56.4	65.6	70.1	77.0	80.0	87.0	92.6	108.4	133.3	167.4	186.6	223.9	239.9	258.0
Insurance companies	32.5	36.1	44.5	53.6	58.8	64.3	72.5	72.8	90.2	105.6	128.5	162.2	189.5	217.9	244.4	267.0
Hospitals	...	...	...	...	...	...	...	...	...	...	...	...	107.1	129.5	147.2	162.6
Hotels	15.6	19.7	14.4	16.0	18.4	27.5	...	...	...	...	...	...	...	...	...	...
Miscellaneous nonmanufacturing industries	31.3	46.1	57.0	66.6	68.8	68.8	73.2	74.1	83.7	104.8	112.4	151.1	206.9	251.8	288.2	285.8

... *Data not shown separately for this industry group.*

Table 11.

Total Employee Benefits as Dollars per Year per Employee, by Industry Groups, 1951-79.

Industry group	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total, all industries	644	720	819	981	1,132	1,254	1,431	1,502	1,719	2,052	2,544	3,230	3,984	4,692	5,138	5,560
Total, all manufacturing	599	667	801	940	1,103	1,236	1,372	1,437	1,656	1,965	2,482	3,111	3,954	4,683	5,164	5,605
Manufacture of:																
Food, beverages, and tobacco	636	752	827	961	1,078	1,314	1,517	1,620	1,682	2,143	2,668	3,024	3,822	4,307	4,713	5,193
Textile products and apparel	433	451	553	626	801	767	855	839	962	1,198	1,501	1,834	2,183	2,639	2,786	3,098
Pulp, paper, lumber, and furniture	535	568	673	794	930	994	1,210	1,245	1,460	1,652	2,229	2,794	3,447	4,134	4,611	5,062
Printing and publishing	574	674	907	1,007	1,077	1,156	1,250	1,358	1,827	1,996	2,272	2,853	3,633	4,312	4,734	5,114
Chemicals and allied products	725	846	946	1,110	1,303	1,505	1,614	1,692	2,086	2,444	3,028	3,721	5,008	5,894	6,459	7,061
Petroleum industry	975	1,178	1,278	1,650	1,754	1,719	1,977	2,143	2,539	2,938	3,443	4,258	5,280	6,481	7,715	9,125
Rubber, leather, and plastic products	512	541	698	897	1,039	1,302	1,316	1,358	1,618	1,798	2,290	3,121	3,915	4,367	4,042	4,611
Stone, clay, and glass products	477	587	676	835	980	1,162	1,219	1,377	1,464	1,921	2,468	3,059	3,694	4,390	4,903	5,249
Primary metal industries	575	716	787	975	1,212	1,377	1,500	1,656	1,902	2,298	2,761	3,395	4,784	5,747	5,875	6,575
Fabricated metal products (excluding machinery and transportation equipment)	598	648	825	959	1,100	1,258	1,421	1,404	1,593	1,784	2,347	3,241	3,723	4,574	5,099	5,324
Machinery (excluding electrical)	630	674	851	1,071	1,142	1,319	1,403	1,553	1,722	2,053	2,506	3,277	4,162	4,883	5,568	5,919
Electrical machinery, equipment, and supplies	583	666	801	903	1,083	1,203	1,327	1,348	1,539	1,879	2,427	2,880	3,834	4,489	5,103	5,554
Transportation equipment	594	649	820	1,099	1,156	1,312	1,463	1,523	1,763	2,146	2,879	3,490	4,582	5,303	6,321	6,665
Instruments and miscellaneous manufacturing industries	571	630	798	952	1,101	1,312	1,434	1,364	1,556	1,812	2,429	3,015	3,590	3,942	4,839	5,252
Total, all nonmanufacturing	709	809	847	1,035	1,188	1,335	1,525	1,618	1,822	2,181	2,637	3,398	4,025	4,704	5,083	5,501
Public utilities (electric, gas, water, telephone, etc.)	769	845	1,019	1,165	1,342	1,497	1,625	1,825	2,133	2,551	3,038	3,917	5,003	6,005	6,681	7,486
Department stores	...	...	...	...	...	...	...	961	1,010	1,128	1,347	1,965	2,141	2,650	2,866	3,034
Trade (wholesale and other retail)	517	551	698	872	912	1,059	1,196	1,188	1,252	1,298	1,843	2,345	2,795	3,478	3,719	3,857
Banks, finance companies, and trust companies	813	939	1,125	1,294	1,384	1,522	1,591	1,715	1,831	2,171	2,708	3,344	3,745	4,482	4,886	5,277
Insurance companies	621	706	873	1,056	1,152	1,259	1,429	1,427	1,769	2,070	2,513	3,189	3,717	4,262	4,790	5,268
Hospitals	...	...	...	...	...	...	...	...	...	...	...	...	2,204	2,675	3,062	3,359
Hotels	353	442	332	354	401	601	...	...	...	...	...	...	...	...	...	...
Miscellaneous nonmanufacturing industries	592	882	1,037	1,329	1,461	1,390	1,550	1,552	1,802	2,219	2,383	3,192	4,384	5,168	5,918	5,775

... Data not shown separately for this industry group.

Table 12.

Total Employee Benefits as Percent of Payroll, by Region, and by Size of Company, 1951-79.

Item	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
By region																
Total, all regions[*]	18.7	19.2	20.3	21.8	22.8	24.9	25.6	24.7	26.6	27.9	30.8	32.7	35.4	36.7	36.9	36.6
Northeast	19.7	20.7	22.3	23.4	24.6	26.5	27.0	26.6	28.4	29.1	32.8	35.0	36.9	37.8	37.7	38.1
East North Central	17.7	17.3	19.1	20.6	21.7	23.9	24.9	24.6	26.1	28.5	31.4	33.3	36.2	37.9	38.7	37.9
Southeast	17.2	18.8	19.0	21.2	21.0	23.3	24.9	22.1	24.9	25.7	28.2	29.0	32.7	33.7	33.5	33.9
West	19.8	19.5	19.4	20.9	22.7	23.7	24.9	24.1	25.3	27.0	29.4	31.6	34.4	36.4	35.8	35.2
By size of company																
Total, all companies	18.7	19.2	20.3	21.8	22.8	24.9	25.6	24.7	26.6	27.9	30.8	32.7	35.4	36.7	36.9	36.6
Under 500 employees	19.4	20.2	19.4	21.1	22.3	24.1	24.6	23.7	25.8	27.0	29.2	31.6	34.0	35.6	35.3	35.1
500-999 employees	18.5	18.6	20.7	22.1	22.5	24.5	25.3	24.6	26.6	27.7	30.2	30.8	33.4	36.7	35.9	35.2
1,000-2,499 employees	18.5	18.8	20.9	22.3	23.5	25.5	26.6	25.8	27.1	28.4	31.5	33.8	36.8	35.8	36.5	37.5
2,500-4,999 employees	18.8	18.6	20.3	21.6	23.7	25.3	26.9	25.3	27.3	29.3	33.4	34.9	36.2	37.3	39.4	38.1
5,000 employees and over	18.4	19.0	21.5	23.0	23.0	25.3	26.1	25.6	29.4	29.6	33.0	34.6	38.1	40.0	40.8	40.5

[*] *States in each region are:*
NORTHEAST: Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, and Vermont.
EAST NORTH CENTRAL: Illinois, Indiana, Michigan, Ohio, and Wisconsin.
SOUTHEAST: Alabama, Arkansas, Delaware, District of Columbia, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia, and West Virginia.
WEST: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Iowa, Kansas, Minnesota, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington, and Wyoming.

Chart 4.

Total Employee Benefits as Percent of Payroll, by Region, 1951-79.

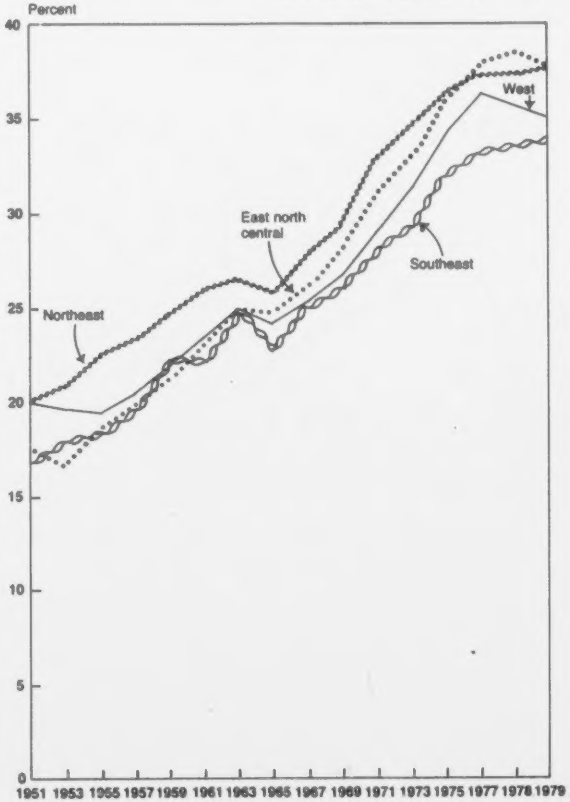


Chart 5.

Total Employee Benefits as Percent of Payroll, by Size of Company, 1951-79.

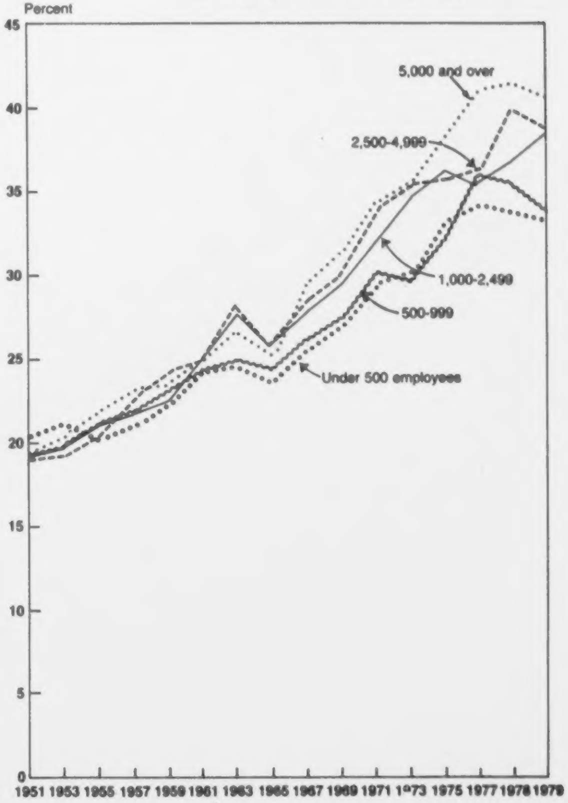


Table 13.

Pensions as Percent of Payroll for All Companies in Surveys, by Industry Groups, 1951-79.

Industry groups	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total, all industries	3.6	3.8	3.8	4.1	4.3	4.2	3.9	3.7	4.0	4.2	4.9	5.1	5.5	5.9	5.6	5.4
Total, all manufacturing	2.4	2.6	2.8	3.1	3.3	3.4	3.0	2.8	3.2	3.3	4.1	4.3	4.9	5.3	4.9	4.7
Manufacture of:																
Food, beverages, and tobacco	1.8	2.4	2.7	3.3	3.1	4.1	4.2	3.5	4.1	4.4	5.1	5.3	5.7	6.1	4.6	5.9
Textile products and apparel	1.3	1.6	2.0	1.9	2.7	1.7	2.3	1.1	1.6	2.0	2.3	2.8	2.9	2.0	2.1	2.0
Pulp, paper, lumber, and furniture	1.8	2.1	1.9	2.3	2.6	2.6	2.7	2.3	2.3	2.2	3.0	3.2	3.5	4.1	4.6	4.1
Printing and publishing	2.5	3.3	4.0	3.5	2.8	2.1	2.0	2.2	3.4	3.3	3.6	3.9	4.1	5.1	4.9	5.0
Chemicals and allied products	3.3	3.6	4.0	4.0	4.3	4.7	4.4	4.1	4.3	4.0	4.4	5.6	6.5	6.9	6.7	6.4
Petroleum industry	8.1	8.8	7.4	8.6	8.9	8.2	7.6	4.1	4.7	4.9	7.2	8.0	9.3	9.6	10.3	11.1
Rubber, leather, and plastic products	1.1	1.6	1.8	3.5	3.8	3.9	3.3	3.1	3.4	3.8	5.3	4.5	6.7	4.9	2.5	3.3
Stone, clay, and glass products	3.4	3.0	2.9	3.5	3.1	3.2	3.1	2.6	3.7	3.9	4.9	5.5	4.7	5.9	5.2	5.2
Primary metal industries	3.2	2.9	2.6	2.8	3.5	3.5	3.4	3.5	4.5	4.5	5.3	5.1	7.2	6.7	5.6	5.7
Fabricated metal products (excluding machinery and transportation equipment)	2.1	2.0	2.7	2.9	3.0	3.6	3.6	2.6	2.9	2.4	3.5	3.9	4.4	4.4	4.6	4.1
Machinery (excluding electrical)	2.1	2.5	2.9	3.5	3.8	3.7	3.8	3.3	3.5	3.3	3.9	4.1	4.7	5.3	5.3	4.8
Electrical machinery, equipment, and supplies	1.8	2.2	2.5	2.4	2.9	3.0	2.8	2.6	2.4	3.1	3.6	3.8	3.8	4.9	4.6	3.7
Transportation equipment	1.8	2.0	2.5	3.3	3.3	3.2	2.9	2.9	3.3	3.5	4.6	4.7	5.3	6.1	5.4	4.9
Instruments and miscellaneous manufacturing industries	2.8	3.3	2.8	2.8	3.2	3.8	3.5	2.6	2.4	2.6	4.3	3.7	4.4	4.3	4.9	4.5
Total, all nonmanufacturing	5.2	5.8	5.3	5.9	6.1	5.9	5.7	5.5	5.4	5.5	6.0	6.2	6.4	6.9	6.5	6.4
Public utilities (electric, gas, water, telephone, etc.)	5.8	6.2	6.7	6.6	7.2	6.7	6.8	6.8	6.8	6.8	7.8	7.6	8.7	9.5	9.6	9.8
Department stores	...	...	...	...	...	...	...	1.9	2.0	1.7	1.8	2.5	2.7	2.1	2.7	2.7
Trade (wholesale and other retail)	1.5	1.9	2.2	2.3	2.3	2.0	2.4	1.7	2.0	1.6	2.3	2.4	2.6	3.2	2.4	2.2
Banks, finance companies, and trust companies	6.4	7.3	7.8	8.2	7.8	7.7	7.3	6.8	6.1	6.1	6.2	6.1	6.4	7.5	7.0	6.4
Insurance companies	5.6	5.4	6.9	7.9	8.1	7.4	7.1	6.2	6.7	6.7	6.9	7.0	7.0	7.2	7.2	7.1
Hospitals	...	...	...	...	...	...	...	...	...	...	...	...	2.5	3.3	2.8	3.5
Hotels	1.4	2.4	0.4	0.8	0.6	0.7	...	...	...	...	...	...	...	...	...	...
Miscellaneous nonmanufacturing industries	1.8	3.6	5.9	2.7	2.5	2.1	2.2	2.4	2.5	3.4	2.9	4.0	4.2	5.1	6.0	4.8

... *Data not shown separately for this industry group.*

Table 14.

Pensions as Percent of Payroll for Companies Reporting Pension Payments, 1955-79.

Industry group	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total, all industries	5.1	5.1	5.0	4.9	4.6	4.4	4.8	4.8	5.5	5.7	6.2	6.5	6.3	6.3
Total, all manufacturing	3.8	3.9	3.9	4.0	3.7	3.4	3.9	4.0	4.6	4.8	5.6	5.8	5.6	5.5
Manufacture of:														
Food, beverages, and tobacco	4.0	4.1	3.5	4.6	4.7	4.1	4.8	4.8	5.6	5.8	5.9	6.4	5.2	6.4
Textile products and apparel	3.3	3.1	3.6	2.9	3.8	2.1	2.7	2.9	2.7	3.3	3.6	2.6	2.5	2.9
Pulp, paper, lumber, and furniture	2.9	2.9	3.3	3.0	3.2	2.8	3.3	2.7	3.6	3.4	4.0	4.6	5.1	5.1
Printing and publishing	5.3	4.2	3.0	2.5	3.1	2.7	3.8	3.7	3.8	4.4	4.7	5.1	5.3	5.6
Chemicals and allied products	4.4	4.5	4.8	5.1	4.7	4.7	4.9	4.5	4.9	5.8	6.5	7.2	6.9	6.8
Petroleum industry	8.3	8.6	8.9	8.8	8.5	4.8	4.7	4.9	7.2	6.0	9.3	9.6	10.3	11.1
Rubber, leather, and plastic products	3.2	4.0	4.3	5.2	4.9	3.9	3.6	4.2	5.7	4.5	6.7	4.9	3.3	4.0
Stone, clay, and glass products	3.8	4.4	3.6	3.6	4.2	3.6	4.3	4.5	5.4	5.7	4.9	6.2	5.5	5.2
Primary metal industries	3.3	3.3	4.1	4.0	4.0	3.9	4.9	4.9	5.6	5.4	7.6	6.7	6.5	6.5
Fabricated metal products (excluding machinery and transportation equipment)	4.0	3.8	3.7	4.3	4.4	3.1	3.5	3.2	4.2	4.5	5.0	5.2	5.5	4.9
Machinery (excluding electrical)	3.7	4.4	4.4	4.2	4.4	3.8	4.0	4.0	4.8	4.8	5.5	6.0	6.0	5.7
Electrical machinery, equipment, and supplies	3.4	3.7	3.6	3.9	3.7	3.3	3.3	3.9	4.6	5.1	4.9	5.6	5.8	5.1
Transportation equipment	3.4	4.0	3.9	3.4	3.3	3.1	3.9	3.9	4.7	5.2	6.0	6.5	5.8	5.4
Instruments and miscellaneous manufacturing industries	4.1	3.5	3.8	4.4	4.7	2.8	3.3	3.8	4.7	4.2	5.5	4.8	5.4	5.5
Total, all nonmanufacturing	6.9	7.0	6.9	6.7	6.1	6.0	6.0	6.3	6.0	6.7	7.0	7.5	7.2	7.3
Public utilities (electric, gas, water, telephone, etc.)	6.8	6.7	7.3	6.8	6.9	6.9	6.9	7.0	7.8	7.6	9.0	9.5	9.8	9.9
Department stores	...	...	...	...	...	2.4	2.3	2.2	2.3	3.0	3.1	3.2	2.9	3.2
Trade (wholesale and other retail)	2.6	2.6	2.8	2.4	2.7	2.2	2.7	2.3	3.0	3.4	3.1	4.8	3.5	4.0
Banks, finance companies, and trust companies	8.1	8.5	8.1	7.9	7.7	7.2	5.9	6.8	6.8	6.3	7.1	7.9	7.6	6.6
Insurance companies	7.1	7.9	8.1	7.7	7.5	6.6	6.9	6.8	7.3	7.3	7.5	7.4	7.6	7.8
Hospitals	...	...	...	...	...	...	...	...	...	...	2.6	3.4	2.7	3.7
Hotels	2.7	3.2	2.9	2.4	...	...	...	...	...	...	...	...	...	...
Miscellaneous nonmanufacturing industries	10.7	3.2	3.9	3.4	3.1	3.3	3.7	4.5	3.8	5.2	5.9	6.9	8.0	6.9

... Data not shown separately for this industry group.

Table 15.

Distribution of Pension Payments as Percent of Payroll, 1951-79.

Item	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Average pension payments as percent of payroll:																
All companies	3.6	3.8	3.8	4.1	4.3	4.2	3.9	3.7	4.0	4.2	4.9	5.1	5.5	5.9	5.6	5.4
Companies reporting pension payments	4.7	4.8	5.1	5.1	5.0	4.9	4.6	4.4	4.8	4.8	5.5	5.7	6.2	6.5	6.3	6.3
Percent of companies reporting pension payments	77	80	75	81	86	86	85	85	85	86	89	90	89	91	89	86
Percentage distribution of pension payments:																
0%	23	20	25	19	14	14	15	15	15	14	11	10	11	9	11	14
0.1-1.9%	19	18	14	15	15	14	15	15	15	15	11	9	9	7	8	8
2.0-3.9%	19	22	19	20	25	26	31	32	28	25	24	23	21	20	21	20
4.0-5.9%	17	18	19	22	21	21	19	18	18	21	20	22	18	19	21	19
6.0-7.9%	11	11	11	10	12	11	10	10	11	12	15	17	16	16	14	14
8.0-9.9%	6	5	6	7	7	7	5	5	7	7	10	10	11	13	10	11
10.0-11.9%	3	3	3	3	3	3	3	3	4	3	5	5	8	9	8	7
12.0-13.9%	1	2	2	2	1	2	1	1	1	2	2	2	4	4	3	4
14.0% and over	1	1	1	2	2	2	1	1	1	1	2	2	2	3	4	3
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Pension payments as percent of payroll:																
Premium payments	...	...	...	...	3.3	3.2	2.9	2.8	...	...	...	...	...	...	...	...
Payments not covered by insurance-type plan	...	...	...	...	1.0	1.0	1.0	0.9	...	...	...	...	...	...	...	...
Premiums under insurance and annuity contracts	...	...	...	...	...	...	...	...	2.3	2.4	2.6	2.9	3.0	3.3	3.2	3.1
Payments to uninsured trusteed pension plans	...	...	...	...	...	...	...	...	1.4	1.5	2.0	2.0	2.3	2.4	2.2	2.1
Payments under unfunded pension plans	...	...	...	...	...	...	...	...	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Total	3.6	3.8	3.8	4.1	4.3	4.2	3.9	3.7	4.0	4.2	4.9	5.1	5.5	5.9	5.6	5.4
Percent of companies reporting payroll deductions for pensions	...	...	34	31	31	26	28	26	26	24	21	20	18	17	17	15
Deductions for pensions as percent of payroll:																
All companies	...	...	0.5	0.5	0.6	0.5	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.2	0.2	0.3
Companies reporting deductions	...	...	1.8	1.6	1.8	1.9	1.7	1.8	1.7	1.6	1.6	1.5	1.5	1.4	1.4	1.8

... This item is not shown separately.

Table 16.

Insurance Payments as Percent of Payroll for All Companies in Surveys, 1951-79.

Industry Group	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total, all industries	1.4	1.8	2.0	2.2	2.3	2.7	2.9	3.0	3.2	3.5	4.5	4.6	5.2	5.9	5.6	5.7
Total, all manufacturing	1.4	1.8	2.0	2.3	2.4	3.0	3.2	3.3	3.5	4.0	5.3	5.3	6.1	6.9	6.3	6.6
Manufacture of:																
Food, beverages, and tobacco	1.5	2.3	2.6	2.4	2.6	2.9	3.2	3.8	3.5	4.0	5.0	4.2	5.1	5.6	6.0	6.4
Textile products and apparel	1.5	2.0	2.0	1.9	2.0	2.2	2.2	2.1	2.2	2.6	3.4	3.7	4.1	4.9	4.2	5.3
Pulp, paper, lumber, and furniture	1.5	1.3	1.7	1.8	2.1	2.4	2.7	2.8	3.0	3.5	4.9	5.0	5.6	6.3	5.3	5.9
Printing and publishing	1.1	1.0	1.3	1.5	1.6	1.8	2.0	2.2	2.5	2.8	2.9	3.6	4.9	5.0	4.7	5.4
Chemicals and allied products	1.3	1.8	1.9	2.1	2.4	3.0	3.1	3.3	3.5	4.0	4.7	5.1	5.8	7.2	6.1	6.6
Petroleum industry	0.9	1.5	1.6	1.7	1.7	1.8	1.8	2.5	3.2	3.8	3.9	3.3	3.7	4.0	4.5	6.5
Rubber, leather, and plastic products	1.7	1.6	2.3	3.0	3.1	4.1	3.6	4.2	4.1	4.3	5.8	5.5	8.0	7.9	6.0	6.0
Stone, clay, and glass products	1.3	1.9	1.7	2.1	2.1	2.9	3.0	3.1	3.2	4.1	5.7	6.3	6.3	7.2	7.6	6.7
Primary metal industries	1.5	2.0	2.5	2.7	3.1	4.6	4.7	4.9	4.8	5.8	7.4	7.2	8.1	9.8	8.1	7.9
Fabricated metal products (excluding machinery and transportation equipment)	1.9	2.0	2.4	2.6	2.7	3.2	3.6	3.4	3.7	4.0	5.5	6.1	6.2	7.1	6.9	6.8
Machinery (excluding electrical)	1.4	1.8	2.1	2.3	2.5	3.1	3.3	3.8	3.7	4.4	5.5	5.8	6.9	8.2	7.1	6.7
Electrical machinery, equipment, and supplies	1.4	1.7	1.7	2.1	2.3	2.8	2.9	3.1	3.4	3.9	4.9	4.7	5.5	6.4	6.1	5.9
Transportation equipment	1.3	1.7	2.1	2.6	2.6	2.7	3.3	3.5	3.5	4.7	6.9	6.3	7.8	7.5	7.8	8.1
Instruments and miscellaneous manufacturing industries	1.1	1.6	1.6	1.9	2.1	2.6	3.1	3.0	3.3	3.4	4.4	4.1	5.4	5.8	5.4	5.7
Total, all nonmanufacturing	1.3	1.8	1.9	1.9	2.1	2.1	2.3	2.4	2.6	2.8	3.3	3.6	3.8	4.6	4.5	4.4
Public utilities (electric, gas, water, telephone, etc.)	1.3	1.4	1.8	1.8	2.0	2.1	2.3	2.6	3.2	3.3	3.8	4.2	4.5	5.1	5.2	5.2
Department stores	...	...	...	...	...	...	...	1.4	1.4	1.6	1.8	2.0	2.5	4.0	3.1	3.0
Trade (wholesale and other retail)	1.0	1.4	1.6	1.7	1.5	1.5	1.7	2.0	2.4	2.2	3.2	3.2	3.3	4.2	4.0	4.1
Banks, finance companies, and trust companies	1.6	2.2	2.2	2.2	2.5	2.7	2.7	2.7	2.6	2.9	3.5	3.8	3.7	4.9	4.7	4.9
Insurance companies	1.2	1.5	1.9	1.8	2.0	1.8	1.9	2.3	2.4	2.4	2.6	3.3	3.3	4.2	4.3	4.3
Hospitals	...	...	...	...	...	...	...	...	...	...	...	...	2.9	3.7	3.6	3.6
Hotels	1.9	3.1	1.9	1.8	1.9	1.8	...	...	...	...	...	...	...	...	...	...
Miscellaneous nonmanufacturing industries	0.2	2.6	1.1	1.6	2.0	2.1	2.0	2.2	2.5	2.9	2.8	2.9	3.8	4.4	4.9	4.1

... Data not shown separately for this industry group.

Table 17.

Insurance Payments as Percent of Payroll for Companies Reporting Insurance Payments, 1955-79.

Industry group	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Total, all industries	2.1	2.3	2.3	2.8	2.9	3.0	3.2	3.6	4.5	4.7	5.2	5.9	5.6	5.7
Total, all manufacturing	2.0	2.3	2.4	3.0	3.2	3.3	3.6	4.0	5.3	5.4	6.1	7.0	6.4	6.6
Manufacture of:														
Food, beverages, and tobacco	2.7	2.5	2.7	3.0	3.3	3.8	3.5	4.1	5.2	4.4	5.1	5.9	6.0	6.4
Textile products and apparel	2.0	2.0	2.0	2.3	2.3	2.1	2.2	2.6	3.5	3.7	4.1	4.9	4.4	5.3
Pulp, paper, lumber, and furniture	1.8	1.9	2.1	2.4	2.7	2.8	3.2	3.5	4.9	5.1	5.6	6.6	5.3	5.9
Printing and publishing	1.3	1.5	1.6	1.8	2.0	2.2	2.6	2.9	3.0	3.6	4.9	5.0	4.9	5.4
Chemicals and allied products	1.9	2.1	2.4	3.1	3.1	3.4	3.5	4.0	4.7	5.1	5.8	7.2	6.2	6.6
Petroleum industry	1.6	1.7	1.7	1.8	1.8	2.5	3.2	3.8	3.9	3.7	3.7	4.4	4.5	5.5
Rubber, leather, and plastic products	2.3	3.0	3.1	4.1	3.6	4.2	4.2	4.3	5.8	5.5	8.0	7.9	6.0	6.0
Stone, clay, and glass products	1.7	2.2	2.1	2.9	3.0	3.1	3.2	4.1	5.7	6.3	6.3	7.2	7.6	6.7
Primary metal industries	2.5	2.8	3.1	4.7	4.7	4.9	4.9	5.8	7.4	7.2	8.1	9.8	8.1	7.9
Fabricated metal products (excluding machinery and transportation equipment)	2.5	2.7	2.7	3.2	3.6	3.4	3.7	4.0	5.5	6.1	6.3	7.1	6.9	6.8
Machinery (excluding electrical)	2.1	2.3	2.6	3.1	3.3	3.8	3.7	4.4	5.5	5.8	6.9	8.2	7.1	6.7
Electrical machinery, equipment, and supplies	1.7	2.1	2.3	2.8	2.9	3.2	3.4	3.9	5.0	4.9	5.5	6.4	6.1	5.9
Transportation equipment	2.1	2.6	2.6	2.8	3.4	3.6	3.7	4.8	6.9	6.3	7.8	7.5	7.8	8.1
Instruments and miscellaneous manufacturing industries	1.7	2.0	2.2	2.7	3.1	3.0	3.3	3.5	4.4	4.1	5.4	5.8	5.4	5.7
Total, all nonmanufacturing	2.1	2.0	2.2	2.2	2.4	2.4	2.7	2.9	3.3	3.7	3.8	4.6	4.5	4.4
Public utilities (electric, gas, water, telephone, etc.)	1.8	1.8	2.0	2.1	2.3	2.6	3.2	3.3	3.8	4.2	4.5	5.1	5.2	5.2
Department stores	...	...	...	...	...	1.5	1.4	1.7	1.9	2.0	2.5	4.0	3.1	3.0
Trade (wholesale and other retail)	1.6	1.9	1.6	1.5	1.8	2.0	2.5	2.3	3.2	3.6	3.3	4.2	4.5	4.1
Banks, finance companies, and trust companies	2.2	2.2	2.5	2.7	2.7	2.8	2.6	2.9	3.5	3.8	3.7	4.9	4.7	4.9
Insurance companies	2.0	1.8	2.1	1.9	2.0	2.3	2.4	2.4	2.7	3.3	3.3	4.2	4.3	4.3
Hospitals	...	...	...	...	...	...	...	...	...	...	2.9	3.7	3.6	3.6
Hotels	2.6	1.9	2.3	2.2	...	...	...	...	...	...	...	...	...	...
Miscellaneous nonmanufacturing industries	1.7	2.0	2.4	2.3	2.3	2.3	2.7	2.9	2.9	2.9	4.0	4.4	5.0	4.1

... Data not shown separately for this industry group.

Table 18.

Distribution of Insurance Payments as Percent of Payroll, 1951-79.

Item	1951	1953	1955	1957	1959	1951	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Average insurance payments as percent of payroll:																
All companies	1.4	1.8	2.0	2.2	2.3	2.7	2.9	3.0	3.2	3.5	4.5	4.6	5.2	5.9	5.6	5.7
Companies reporting insurance payments	1.5	1.9	2.1	2.3	2.3	2.8	2.9	3.0	3.2	3.6	4.5	4.7	5.2	5.9	5.6	5.7
Percent of companies reporting insurance payments	96	97	96	97	98	98	99	99	98	99	99	99	100	100	99	100
Percentage distribution of insurance payments:																
0%	4	3	4	3	2	2	1	1	2	1	1	1	*	*	1	0
0.1-1.9%	74	64	53	45	41	35	30	28	24	21	11	10	8	4	5	4
2.0-3.9%	20	28	36	44	48	46	45	44	44	42	34	32	27	21	23	24
4.0-5.9%	2	4	6	7	8	14	19	22	23	26	30	31	34	32	33	34
6.0-7.9%	*	1	1	1	1	2	4	4	5	7	15	17	18	22	23	23
8.0-9.9%	0	*	*	*	*	1	1	1	1	2	6	6	9	11	8	10
10.0-11.9%	0	0	0	0	*	*	*	0	1	1	2	2	2	6	4	4
12.0-13.9%	0	0	0	0	0	0	0	*	*	*	1	1	1	2	2	1
14.0% and over	0	0	0	0	0	*	*	0	*	*	*	0	1	2	1	*
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Average insurance payment as percent of payroll, all companies:																
Life	...	...	...	...	...	...	...	...	...	...	0.8	0.7	0.8	0.7	0.7	0.7
Health	...	...	...	...	...	...	...	...	...	...	3.2	3.5	3.9	4.4	4.4	4.4
Life and health**	...	...	...	...	...	...	...	...	...	...	0.5	0.4	0.5	0.8	0.5	0.6
Total	...	...	...	...	...	...	...	...	...	...	4.5	4.6	5.2	5.9	5.6	5.7
Percent of companies reporting payments for:																
Life	...	...	...	...	...	...	...	...	...	...	79	81	83	83	85	84
Health	...	...	...	...	...	...	...	...	...	...	88	91	90	87	91	91
Life and health**	...	...	...	...	...	...	...	...	...	...	11	8	8	11	8	8
Average for companies reporting specific type of insurance payments:																
Life	...	...	...	...	...	...	...	...	...	...	1.0	0.9	0.9	0.9	0.8	0.8
Health	...	...	...	...	...	...	...	...	...	...	3.8	3.8	4.3	5.0	4.8	4.8
Life and health**	...	...	...	...	...	...	...	...	...	...	4.6	5.0	6.8	7.3	6.3	7.0
Percent of companies reporting payroll deductions for insurance	...	...	87	80	81	80	75	75	74	74	73	70	70	65	68	68
Deductions for insurance as percent of payroll:																
All companies	...	...	1.1	1.1	1.2	1.2	1.2	1.1	1.1	1.0	1.1	1.0	1.0	0.9	0.9	0.8
Companies reporting deductions	...	..	1.3	1.4	1.5	1.5	1.6	1.4	1.4	1.4	1.5	1.4	1.5	1.4	1.3	1.2

... *This item not shown separately.*

* *Less than 0.05¢.*

** *Companies reporting one payment for both life and health.*

Table 19.

Payroll Deductions by Type of Deduction, 1955-79.

Item	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
Payroll deductions as percent of payroll	3.5	3.8	4.2	4.5	4.8	4.4	5.7	6.1	6.0	6.7	7.1	6.6	6.8	7.0
Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	1.8	2.1	2.3	2.7	3.0	2.7	3.9	4.6	4.5	5.3	5.7	5.4	5.6	5.8
Railroad Retirement and state sickness benefits insurance taxes	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Pension plan premiums or contributions	0.5	0.5	0.6	0.5	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.2	0.2	0.3
Life, hospital, surgical, medical, and major medical insurance	1.1	1.1	1.2	1.2	1.2	1.1	1.1	1.0	1.1	1.0	1.0	0.9	0.9	0.8
Payroll deductions as cents per payroll hour	6.8	8.3	9.5	11.1	12.9	12.7	17.6	21.4	23.9	31.6	38.8	41.0	45.6	50.1
Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	3.5	4.4	5.4	6.7	8.1	7.8	12.2	16.0	17.9	25.1	30.9	33.4	37.6	42.3
Railroad Retirement and state sickness benefits insurance taxes	0.2	0.2	0.2	0.2	0.3	0.3	0.4	0.4	0.4	0.4	0.6	0.6	0.6	0.6
Pension plan premiums	1.0	1.1	1.3	1.2	1.3	1.4	1.6	1.5	1.4	1.4	1.7	1.5	1.4	1.4
Life, hospital, surgical, medical, and major medical insurance	2.1	2.6	2.6	3.0	3.2	3.2	3.4	3.5	4.2	4.7	5.6	5.5	6.0	5.8
Payroll deductions as dollars per year per employee	141	171	209	227	268	268	369	447	498	664	800	850	949	1,042
Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	73	91	112	134	168	163	254	335	372	527	636	693	783	877
Railroad Retirement and state sickness benefits insurance taxes	4	5	5	5	5	6	8	7	8	9	11	13	14	14
Pension plan premiums or contributions	20	24	30	25	28	31	33	30	25	29	36	26	27	30
Life, hospital, surgical, medical, and major medical insurance	44	51	62	63	67	68	74	75	93	99	117	118	125	121

Table 20.

Wage Data, 1951-79.

Item	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
As percent of total payroll:																
Total payroll	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Straight-time pay	93.4	93.6	94.2	93.9	93.7	94.7	93.8	93.3	93.4	92.9	93.9	93.0	93.9	93.3	93.4	93.7
Overtime premium pay	3.5	3.5	3.0	2.8	3.0	2.5	3.0	3.6	3.6	4.0	3.3	4.2	3.1	3.6	3.7	3.6
Holiday premium pay	0.4	0.3	0.3	0.4	0.4	0.4	0.4	0.5	0.5	0.6	0.6	0.5	0.6	0.7	0.7	0.6
Shift differential	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.6	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6
Earned incentive or production bonus	1.5	1.6	1.6	1.8	1.7	1.7	1.7	1.4	1.2	1.3	1.0	1.0	1.0	1.0	1.1	1.1
Other payroll items	0.6	0.4	0.4	0.6	0.7	0.2	0.6	0.6	0.8	0.7	0.7	0.7	0.8	0.8	0.5	0.4
As cents per hour:																
Total payroll	168.1	180.2	193.1	217.4	240.4	247.3	268.8	289.5	309.0	352.3	397.1	471.3	545.8	616.9	669.7	731.1
Straight-time pay	157.0	168.8	181.9	204.1	225.3	234.2	252.1	270.3	288.6	327.3	372.4	437.8	512.2	576.2	625.9	684.7
Overtime premium pay	5.9	6.2	5.8	6.1	7.2	6.2	8.1	10.3	11.1	14.1	13.2	20.0	17.0	21.9	24.6	26.4
Holiday premium pay	0.7	0.6	0.6	0.9	0.9	1.0	1.1	1.4	1.6	2.0	2.3	2.5	3.5	4.3	4.6	4.3
Shift differential	1.0	1.1	0.9	1.1	1.2	1.2	1.3	1.7	1.5	1.9	2.1	2.8	3.0	3.6	4.0	4.0
Earned incentive or production bonus	2.5	2.8	3.1	3.9	4.1	4.2	4.6	4.0	3.7	4.5	4.2	4.8	5.6	6.1	7.0	8.4
Other payroll items	1.0	0.7	0.8	1.3	1.7	0.5	1.6	1.8	2.5	2.5	2.9	3.4	4.5	4.8	3.6	3.3
As dollars per year per full-time employee:																
Total payroll	3,437	3,750	4,034	4,500	4,965	5,036	5,591	6,081	6,465	7,355	8,260	9,878	11,254	12,785	13,924	15,191
Straight-time pay	3,210	3,510	3,800	4,225	4,652	4,769	5,244	5,674	6,042	6,835	7,747	9,187	10,561	11,929	13,014	14,227
Overtime premium pay	120	131	121	126	149	126	168	219	231	294	274	415	350	460	511	548
Holiday premium pay	14	11	12	18	20	20	22	31	33	42	49	49	72	89	95	90
Shift differential	21	23	20	23	25	25	28	36	31	40	44	59	62	77	83	84
Earned incentive or production bonus	51	60	65	81	84	86	95	85	77	93	86	99	115	128	146	174
Other payroll items	21	15	16	27	35	10	34	36	51	51	60	69	94	102	75	68

Table 21.

Estimated Employee Benefits, Total United States Economy, by Type of Benefit, 1929-79.

Type of Payment	1929	1951	1953	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
	(Percent of wages and salaries)																
1. Legally required	0.8%	3.3%	3.2%	3.3%	3.7%	4.2%	5.1%	5.6%	5.3%	6.3%	6.6%	7.2%	8.1%	8.4%	9.0%	9.2%	9.4%
Old-Age, Survivors, Disability, and Health Insurance (FICA taxes)	0	1.0	1.2	1.4	1.5	1.7	2.1	2.4	2.3	3.2	3.5	3.7	4.4	4.6	4.5	4.6	4.8
Unemployment Compensation	0	1.0	0.7	0.7	0.8	0.9	1.1	1.2	1.0	0.8	0.7	0.7	1.0	0.8	1.2	1.3	1.2
Workers' compensation	0.6	0.6	0.6	0.5	0.5	0.6	0.7	0.7	0.7	1.0	1.0	1.0	0.9	1.0	1.0	1.0	1.0
Government employee retirement	0.2	0.6	0.6	0.5	0.7	0.8	1.0	1.0	1.0	1.0	1.1	1.5	1.5	1.7	2.0	2.0	2.1
Other	0	0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
2. Agreed-upon	0.4	2.7	3.2	3.6	3.9	4.2	4.6	4.6	4.6	5.0	5.1	5.9	6.3	7.4	8.1	8.1	8.1
Pensions	0.2	1.8	2.0	2.2	2.4	2.6	2.6	2.4	2.3	2.6	2.7	3.0	3.2	3.6	3.7	3.7	3.6
Insurance	0.1	0.7	0.9	1.1	1.2	1.3	1.7	1.9	2.0	2.1	2.1	2.6	2.8	3.4	4.0	4.0	4.1
Other	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4
3. Rest periods	1.0	2.5	2.3	3.0	3.0	3.0	3.2	3.3	3.1	3.3	3.3	3.6	3.6	3.7	3.8	3.8	3.8
4. Time not worked	0.7	5.5	5.7	5.9	6.4	6.6	7.1	7.4	7.3	7.6	7.7	8.4	8.5	9.4	9.5	9.5	9.4
Vacation	0.3	3.0	3.0	3.0	3.3	3.5	3.8	3.9	3.8	3.9	3.9	4.3	4.3	4.8	4.9	4.9	4.8
Holidays	0.3	1.8	1.9	2.0	2.2	2.2	2.4	2.5	2.5	2.6	2.7	2.9	2.9	3.2	3.2	3.2	3.2
Sick leave	0.1	0.6	0.7	0.8	0.8	0.8	0.6	0.8	0.8	0.9	0.9	1.0	1.1	1.2	1.2	1.2	1.2
Other	0	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
5. Bonuses, profit-sharing, etc.	0.1	1.0	1.1	1.2	1.0	1.0	1.0	1.1	1.2	1.3	1.3	0.9	1.0	1.1	1.1	1.1	1.1
Total benefit payments	3.0%	15.0%	15.5%	17.0%	18.0%	19.0%	21.0%	22.0%	21.5%	23.5%	24.0%	26.0%	27.5%	30.0%	31.5%	31.7%	31.8%
	(Billion dollars)																
Wage and salaries	$50.4	$171.1	$198.3	$210.4	$236.1	$258.2	$278.8	$312.1	$358.4	$423.4	$509.0	$573.4	$691.6	$806.6	$983.6	$1,103.5	$1,227.4
Total benefit payments	$1.5	$26.0	$31.0	$36.0	$43.0	$49.0	$58.5	$68.0	$77.0	$100.0	$121.0	$150.0	$190.0	$240.0	$310.0	$350.0	$390.0

Source: Wages and salaries from United States Department of Commerce. Benefits estimated by Chamber of Commerce of the United States.

Table 22.

Estimated Total Employee Benefits, Total United States Economy, by Industry Groups, 1955-79.

Industry group	1955	1957	1959	1961	1963	1965	1967	1969	1971	1973	1975	1977	1978	1979
	Wages and salaries (Billion dollars)													
Manufacturing	72.1	80.6	84.8	87.5	98.0	115.5	134.1	157.5	159.5	196.6	211.7	266.3	298.3	330.9
Trade (wholesale and retail)	36.8	42.1	46.3	50.0	55.7	59.2	69.0	82.5	96.1	113.2	136.2	165.5	186.4	206.8
Services	19.4	22.4	25.7	29.9	34.4	41.4	50.2	63.0	75.4	92.8	116.8	148.5	169.5	190.9
Construction	12.0	13.9	15.2	15.9	17.8	21.1	24.3	30.6	35.0	42.3	44.7	53.4	62.2	72.4
Finance, insurance, and real estate	8.8	10.2	11.7	13.5	15.0	16.8	19.8	24.7	29.6	35.3	43.1	51.6	59.3	66.9
Transportation	12.4	13.9	14.2	14.4	15.4	17.2	19.6	22.9	25.9	30.9	34.2	42.5	47.8	54.4
Utilities and communication	6.2	7.2	7.7	8.4	9.2	10.3	11.9	14.4	17.4	21.0	25.2	31.1	35.2	39.7
Mining	3.7	4.3	3.8	3.7	3.8	4.3	4.7	5.4	6.1	7.4	10.7	14.0	16.3	19.6
Agriculture	3.1	3.4	3.5	3.7	3.6	3.4	3.5	3.9	4.7	5.6	8.2	9.9	10.5	12.3
Private industry	174.5	198.0	212.9	227.0	252.9	289.2	337.1	404.9	449.7	545.1	630.8	782.8	885.5	993.9
Government (federal, state, local)	35.9	40.1	45.3	51.8	59.2	69.2	86.3	104.1	123.7	146.5	175.8	200.8	218.0	233.5
Total, all industries	210.4	238.1	258.2	278.8	312.1	358.4	423.4	509.0	573.4	691.6	806.6	983.6	1,103.5	1,227.4
	Benefit payments (Percent of wages and salaries)													
Manufacturing	16	17	21	23	23	22.5	25	26	29	30	33	34.5	35	35.5
Trade (wholesale and retail)	17	18	15	17	19	20	23	22	23	25	27	28	28.5	28
Services	11	11	11	13	14	14	16	16	18	20	22	24	24.5	24.5
Construction	12	12	15	17	18	17	19	18	22	24	25	26	26.5	26.5
Finance, insurance, and real estate	24	25	26	29	30	30	32	33	35	37	37	39	39	39
Transportation	20	20	21	23	25	25	27	27	29	31	35	38	38	38
Utilities and communication	22	22	28	30	26	28	29	30	33	35	38	41	41.5	41.5
Mining	25	25	26	28	29	28	30	30	31	33	38	40	40.5	42
Agriculture	10	10	10	10	11	13	15	15	17	18	20	22	22	22
Private industry	16	17	18.5	20.5	21	21	23.5	23.5	26	27	30	31.5	31.6	31.7
Government (federal, state, local)	21	24	21	23	24	23	24	25	27	28	30	32	32	32.1
Total, all industries	17	18	19	21	22	21.5	23.5	24	28	27.5	30	31.5	31.7	31.8
	Benefit payments (Billion dollars)													
Manufacturing	11.5	13.5	17.8	20.1	23.0	26.0	33.7	41.0	46.5	58.5	70.0	92.5	104.5	117.0
Trade (wholesale and retail)	6.3	7.5	6.9	8.5	10.5	11.8	16.0	18.0	22.0	28.5	37.0	46.5	53.0	58.0
Services	2.1	2.5	2.8	4.0	4.8	5.8	8.0	10.0	13.5	18.5	25.5	36.0	41.5	47.0
Construction	1.4	1.7	2.3	2.7	3.2	3.6	4.6	5.5	7.6	10.0	11.2	14.0	16.5	19.0
Finance, insurance, and real estate	2.1	2.5	3.1	4.0	4.5	5.0	6.3	8.1	10.5	13.0	16.0	20.0	23.0	26.0
Transportation	2.5	2.8	3.0	3.3	3.9	4.3	5.3	6.1	7.5	9.7	12.0	16.0	18.0	20.5
Utilities and communication	1.4	1.6	2.2	2.5	2.4	2.9	3.5	4.3	5.7	7.4	9.6	12.7	14.6	16.5
Mining	0.9	1.1	1.0	1.0	1.1	1.2	1.4	1.6	1.9	2.4	4.1	5.6	6.6	8.3
Agriculture	0.3	0.3	0.4	0.4	0.4	0.5	0.5	0.6	0.8	1.0	1.6	2.2	2.3	2.7
Private industry	28.5	33.5	39.5	46.5	53.8	61.1	79.3	95.2	116.0	149.0	187.0	245.5	280.0	315.0
Government (federal, state, local)	7.5	9.5	9.5	12.0	14.2	15.9	20.7	25.8	34.0	41.0	53.0	64.5	70.0	75.0
Total, all industries	36.0	43.0	49.0	58.5	68.0	77.0	100.0	121.0	150.0	190.0	240.0	310.0	350.0	390.0

Source: Wages and salaries from United States Department of Commerce. Benefits estimated by Chamber of Commerce of the United States.

Table 23.

Supplements to Wages and Salaries, 1929-79.
(United States Department of Commerce Data.)

(Million dollars)

Type of Supplement	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945
Total supplements to wages and salaries ...	662	657	621	577	542	590	650	990	1,827	2,018	2,167	2,311	2,703	3,162	3,759	4,463	5,604
Employer contributions for social insurance .	101	106	111	126	133	147	171	418	1,234	1,423	1,540	1,624	1,983	2,302	2,677	2,937	3,805
Federal social insurance funds	29	28	27	30	26	29	44	287	1,093	1,276	1,388	1,469	1,818	2,117	2,475	2,725	3,580
Old-Age, Survivors, and Disability Insurance	0	0	0	0	0	0	0	0	288	261	291	329	419	532	625	648	630
Hospital Insurance	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
State unemployment insurance	0	0	0	0	0	3	7	159	588	780	815	813	1,011	1,089	1,246	1,177	1,011
Federal unemployment tax	0	0	0	0	0	0	0	81	89	102	105	98	124	161	183	184	174
Federal civilian employee retirement ...	21	21	22	22	22	22	32	45	63	77	84	93	102	109	147	192	227
Other items	8	7	5	8	4	4	5	2	65	56	93	136	162	226	274	524	1,538
State and local social insurance funds ...	72	78	84	96	107	118	127	131	141	147	152	155	165	185	202	212	225
State and local employee retirement ...	72	78	84	96	107	118	127	131	141	147	152	155	165	185	202	212	225
Other items	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other labor income	561	551	510	451	409	443	479	572	593	595	627	687	720	860	1,082	1,526	1,799
Employer contributions to private pension and welfare funds	169	160	158	148	140	166	180	238	218	228	248	282	314	401	586	948	1,132
Pension and profit-sharing	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Group health insurance	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Group life insurance	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Workers' compensation	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Supplemental unemployment	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other items	392	391	352	303	269	277	299	334	375	367	379	405	406	459	496	578	667

... Data not available.

Table 23—Continued.

Supplements to Wages and Salaries, 1929-79.

(United States Department of Commerce Data.)

(Million dollars)

Type of Supplement	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Total supplements to wages and salaries	6,047	6,077	5,903	6,599	7,818	9,659	10,364	11,024	11,602	13,238	15,164	17,227	17,746	20,644	23,000	24,106	27,055
Employer contributions for social insurance	4,090	3,699	3,188	3,661	4,164	5,033	5,177	5,148	5,487	6,216	7,116	8,188	8,347	10,070	11,780	12,282	14,017
Federal social insurance funds	3,733	3,289	2,696	3,095	3,482	4,214	4,236	4,107	4,282	4,957	5,704	6,591	6,659	8,186	9,645	9,995	11,636
Old-Age, Survivors, and Disability Insurance	687	780	839	816	1,308	1,660	1,776	1,882	2,458	2,825	3,043	3,673	3,657	4,556	5,632	5,700	6,226
Hospital Insurance	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
State unemployment insurance	893	1,029	965	1,010	1,217	1,465	1,350	1,288	1,081	1,221	1,475	1,507	1,503	2,024	2,300	2,464	2,997
Federal unemployment tax	184	212	228	223	232	263	263	298	289	304	326	337	326	337	343	456	947
Federal civilian employee retirement	241	241	244	273	316	316	326	188	42	144	393	599	726	755	838	875	943
Other items	1,728	1,027	420	773	409	510	521	451	412	463	467	475	447	514	532	500	523
State and local social insurance funds	357	410	492	566	682	819	941	1,041	1,205	1,259	1,412	1,597	1,688	1,884	2,135	2,287	2,381
State and local employee retirement	250	290	360	420	510	625	715	790	940	985	1,110	1,270	1,370	1,559	1,775	1,903	1,970
Other items	107	120	132	146	172	194	226	251	265	274	302	327	318	325	360	384	411
Other labor income	1,957	2,378	2,715	2,938	3,654	4,626	5,187	5,876	6,115	7,022	8,048	9,039	9,399	10,574	11,220	11,824	13,038
Employer contributions to private pension and welfare funds	1,231	1,555	2,614	2,828	3,534	4,499	5,049	5,726	5,951	6,845	7,856	8,839	9,185	10,344	10,969	11,555	12,752
Pension and profit-sharing	...	...	1,196	1,262	1,713	2,262	2,543	2,861	2,903	3,377	3,757	4,153	4,134	4,771	4,866	4,966	5,442
Group health insurance	...	...	614	762	1,030	1,320	1,476	1,737	1,454	1,706	2,058	2,440	2,721	3,038	3,374	3,747	4,188
Group life insurance	...	...							465	561	668	766	867	971	1,080	1,133	1,219
Workers' compensation	...	...	804	804	791	917	1,030	1,128	1,129	1,150	1,243	1,312	1,315	1,430	1,529	1,602	1,745
Supplemental unemployment	0	0	0	0	0	0	0	0	0	51	130	168	148	134	120	107	158
Other items	726	823	101	110	120	127	138	150	164	177	192	200	214	230	251	269	286

... Data not available.

Table 23—Continued.

Supplements to Wages and Salaries, 1929-79.
(United States Department of Commerce Data.)

(Million dollars)

Type of Supplement	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Total supplements to wages and salaries	29,497	31,824	34,538	40,927	44,425	50,311	57,184	63,240	70,655	82,779	98,678	112,272	124,980	146,409	168,499	194,293	225,028
Employer contributions for social insurance	15,536	16,099	16,698	21,032	22,774	25,074	28,722	30,733	33,969	39,752	49,842	56,425	60,457	70,544	79,465	92,120	106,432
Federal social insurance funds	12,899	13,202	13,668	17,506	18,610	20,601	23,526	24,889	27,557	32,494	41,475	46,748	48,921	56,806	63,813	74,395	85,762
Old-Age, Survivors, and Disability Insurance	7,464	7,846	8,330	11,033	11,866	13,138	15,621	16,182	18,214	20,612	25,174	29,191	30,490	33,834	37,378	42,928	50,161
Hospital Insurance	0	0	0	1,020	1,545	2,105	2,263	2,342	2,407	2,721	5,255	5,375	5,610	6,225	6,875	8,594	10,487
State unemployment insurance	3,034	3,059	3,076	3,014	2,614	2,536	2,529	2,493	2,721	4,206	5,188	5,553	5,516	8,448	9,643	11,661	12,410
Federal unemployment tax	847	619	558	597	601	634	669	854	853	1,182	1,511	1,289	1,294	1,504	2,270	2,884	3,300
Federal civilian employee retirement	1,034	1,138	1,146	1,244	1,339	1,501	1,719	2,215	2,520	2,872	3,217	3,779	4,353	4,866	5,466	6,013	6,785
Other items	520	540	558	598	645	687	725	803	842	901	1,130	1,561	1,658	1,929	2,181	2,315	2,619
State and local social insurance funds	2,637	2,897	3,030	3,526	4,164	4,473	5,196	5,844	6,412	7,258	8,367	9,677	11,536	13,738	15,652	17,725	20,670
State and local employee retirement	2,187	2,417	2,525	2,980	3,574	3,839	4,513	5,091	5,589	6,350	7,326	8,482	10,170	12,059	13,500	15,011	17,425
Other items	450	480	505	546	590	634	683	753	823	908	1,041	1,195	1,366	1,679	2,152	2,714	3,245
Other labor income	13,961	15,725	17,840	19,895	21,651	25,237	28,462	32,507	36,686	43,027	48,836	55,847	64,523	75,865	89,034	102,173	118,596
Employer contributions to private pension and welfare funds	13,659	15,401	17,485	19,508	21,228	24,773	27,936	31,937	36,047	42,311	48,042	54,996	63,595	74,822	87,892	100,823	117,015
Pension and profit-sharing	5,760	6,591	7,646	8,675	9,456	10,717	11,823	13,050	15,108	17,903	20,934	24,218	28,253	32,972	38,764	44,869	54,899
Group health insurance	4,551	5,182	5,890	6,410	6,869	8,408	9,931	12,099	13,661	16,163	18,014	20,725	24,043	28,835	33,745	37,878	41,574
Group life insurance	1,334	1,481	1,651	1,834	2,036	2,384	2,601	2,891	3,127	3,573	3,673	3,946	4,368	4,418	4,795	5,495	6,009
Workers' compensation	1,861	2,028	2,177	2,453	2,747	3,135	3,469	3,786	3,955	4,406	5,155	5,911	6,695	8,219	10,120	12,018	13,943
Supplemental unemployment	153	119	121	136	120	129	112	111	196	266	266	196	236	378	468	563	590
Other items	302	324	355	387	423	464	526	570	639	716	794	851	928	1,043	1,142	1,350	1,581

Table 24.

Supplements as Percent of Total Wages and Salaries, by Type of Supplement, 1929-79.

(Computed from United States Department of Commerce Data.)

Type of Supplement	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945
Total supplements to wages and salaries	1.3	1.4	1.6	1.9	1.9	1.8	1.8	2.4	4.0	4.7	4.7	4.6	4.4	3.9	3.6	3.8	4.8
Employer contributions for social insurance	0.2	0.2	0.3	0.4	0.5	0.5	0.5	1.0	2.7	3.3	3.3	3.2	3.2	2.8	2.6	2.5	3.2
Other labor income	1.1	1.2	1.3	1.5	1.4	1.3	1.3	1.4	1.3	1.4	1.4	1.4	1.2	1.1	1.0	1.3	1.6
Old-Age, Survivors, and Disability Insurance	0	0	0	0	0	0	0	0	0.6	0.6	0.6	0.7	0.7	0.6	0.6	0.6	0.5
Hospital Insurance	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
State unemployment insurance	0	0	0	0	0	*	*	0.4	1.3	1.8	1.8	1.6	1.6	1.3	1.2	1.0	0.9
Federal civilian employee retirement	*	*	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.1	0.1	0.2	0.2
State and local employee retirement	0.1	0.2	0.2	0.3	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Pension and profit-sharing	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Group health insurance	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Group life insurance	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Workers' compensation**	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Other supplements	1.2	1.2	1.3	1.5	1.4	1.3	1.4	1.6	1.7	1.8	1.8	1.8	1.6	1.7	1.5	1.8	3.0

Type of Supplement	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Total supplements to wages and salaries	5.4	4.9	4.4	4.9	5.3	5.6	5.6	5.6	5.9	6.3	6.6	7.2	7.4	8.0	8.5	8.6	9.1
Employer contributions for social insurance	3.7	3.0	2.4	2.7	2.8	2.9	2.8	2.6	2.8	3.0	3.1	3.4	3.5	3.9	4.4	4.4	4.7
Other labor income	1.7	1.9	2.0	2.2	2.5	2.7	2.8	3.0	3.1	3.3	3.5	3.8	3.9	4.1	4.1	4.2	4.4
Old-Age, Survivors, and Disability Insurance	0.6	0.6	0.6	0.6	0.9	1.0	1.0	0.9	1.2	1.3	1.3	1.5	1.5	1.8	2.1	2.0	2.1
Hospital Insurance	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
State unemployment insurance	0.8	0.8	0.7	0.7	0.8	0.9	0.7	0.6	0.5	0.6	0.6	0.6	0.6	0.8	0.8	0.9	1.0
Federal civilian employee retirement	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	*	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3
State and local employee retirement	0.2	0.2	0.3	0.3	0.3	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.6	0.6	0.7	0.7	0.7
Pension and profit-sharing	...	...	0.9	0.9	1.2	1.3	1.4	1.4	1.5	1.6	1.6	1.7	1.7	1.8	1.8	1.8	1.8
Group health insurance	...	...	0.5	0.6	0.7	0.8	0.8	0.9	0.7	0.8	0.9	1.0	1.1	1.2	1.2	1.3	1.4
Group life insurance	...	...							0.2	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4
Workers' compensation**	...	...	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Other supplements	3.6	3.1	0.5	0.9	0.5	0.3	0.4	0.6	0.6	0.4	0.5	0.6	0.5	0.4	0.5	0.5	0.7

... *Data not available.*

* *Less than 0.05%.*

** *Includes federal, state, and local government workers' compensation, not shown separately in Table 23.*

Table 24—Continued.

Supplements as Percent of Total Wages and Salaries, by Type of Supplement, 1929-79.

(Computed from United States Department of Commerce Data.)

Type of Supplement	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Total supplements to wages and salaries	9.4	9.5	9.5	10.3	10.4	10.7	11.1	11.5	12.1	13.0	14.0	14.7	15.5	16.4	17.1	17.6	18.2
Employer contributions for social insurance	5.0	4.8	4.6	5.3	5.3	5.3	5.6	5.6	5.8	6.2	7.1	7.4	7.5	7.9	8.1	8.3	8.6
Other labor income	4.4	4.7	4.9	5.0	5.1	5.4	5.5	5.9	6.3	6.8	6.9	7.3	8.0	8.5	9.0	9.3	9.6
Old-Age, Survivors, and Disability Insurance	2.4	2.3	2.3	2.8	2.8	2.8	3.0	2.9	3.1	3.2	3.6	3.8	3.8	3.8	3.8	3.9	4.1
Hospital Insurance	0	0	0	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.7	0.7	0.7	0.7	0.7	0.8	0.8
State unemployment insurance	1.0	0.9	0.8	0.8	0.6	0.5	0.5	0.5	0.5	0.7	0.7	0.7	0.7	0.9	1.0	1.1	1.0
Federal civilian employee retirement	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.6	0.5	0.5
State and local employee retirement	0.7	0.7	0.7	0.7	0.8	0.8	0.9	0.9	1.0	1.0	1.0	1.1	1.3	1.4	1.4	1.4	1.4
Pension and profit-sharing	1.8	2.0	2.1	2.2	2.2	2.3	2.3	2.4	2.6	2.8	3.0	3.2	3.5	3.7	3.9	4.1	4.4
Group health insurance	1.5	1.5	1.6	1.6	1.6	1.8	1.9	2.2	2.3	2.5	2.6	2.7	3.0	3.2	3.4	3.4	3.4
Group life insurance	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Workers' compensation*	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.9	0.9	1.0	1.0	1.2	1.3	1.4	1.4
Other supplements	0.5	0.6	0.4	0.3	0.4	0.5	0.5	0.5	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.7

**Includes federal, state, and local government workers' compensation, not shown separately in Table 23.*

Table 25.

Supplements as Percent of Wages and Salaries, by Industry Groups, 1929-79.

(Computed from United States Department of Commerce Data.)

Industry group	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945
All industries	1.3	1.4	1.6	1.9	1.9	1.8	1.8	2.4	4.0	4.7	4.7	4.6	4.4	3.9	3.6	3.8	4.8
Agriculture, forestry, and fisheries	0.4	0.4	0.5	0.7	0.6	0.5	0.5	0.4	0.5	0.6	0.6	0.6	0.4	0.4	0.3	0.4	0.4
Mining	1.6	1.7	1.8	2.2	2.0	1.8	1.7	2.6	4.8	6.3	5.9	5.7	5.3	4.9	4.5	4.0	4.0
Contract construction	2.3	2.7	3.5	4.9	4.6	3.8	3.5	3.8	5.8	7.1	6.7	6.6	6.0	5.5	5.1	5.2	5.3
Manufacturing	0.9	1.0	1.1	1.4	1.2	1.1	1.2	2.1	4.2	5.5	5.4	5.2	4.9	4.3	4.3	4.8	5.1
Transportation	2.0	2.2	2.6	3.0	3.3	4.0	2.7	3.7	6.0	6.3	6.3	6.2	6.2	6.4	6.1	5.9	6.0
Communication	2.1	2.0	2.2	2.6	4.4	4.1	4.4	4.9	6.9	8.1	7.9	8.8	9.5	9.2	9.1	9.1	8.9
Electric, gas, and sanitary services	1.7	1.8	1.9	1.8	1.6	1.5	2.2	3.3	5.3	6.7	6.7	6.2	5.6	4.9	5.3	8.1	9.4
Wholesale and retail trade	0.6	0.6	0.7	0.8	0.8	0.7	0.8	1.5	3.3	4.1	4.1	3.9	3.7	3.4	3.3	3.5	3.4
Finance, insurance, and real estate	2.4	2.4	2.4	2.5	2.3	2.2	2.6	3.4	4.9	5.9	6.0	6.0	5.9	5.6	6.3	6.0	5.1
Services	0.4	0.5	0.5	0.6	0.6	0.6	0.6	1.1	2.1	2.7	2.5	2.4	2.5	2.3	2.2	2.2	2.2
Government and government enterprises	3.2	3.2	3.2	3.7	3.6	3.2	3.4	3.1	3.7	3.7	4.0	4.1	3.1	2.2	1.6	2.3	5.3
All private enterprises	1.1	1.2	1.3	1.5	1.5	1.4	1.4	2.2	4.0	4.9	4.9	4.8	4.6	4.2	4.2	4.4	4.5

Table 25—Continued.

Supplements as Percent of Wages and Salaries, by Industry Groups, 1929-79.

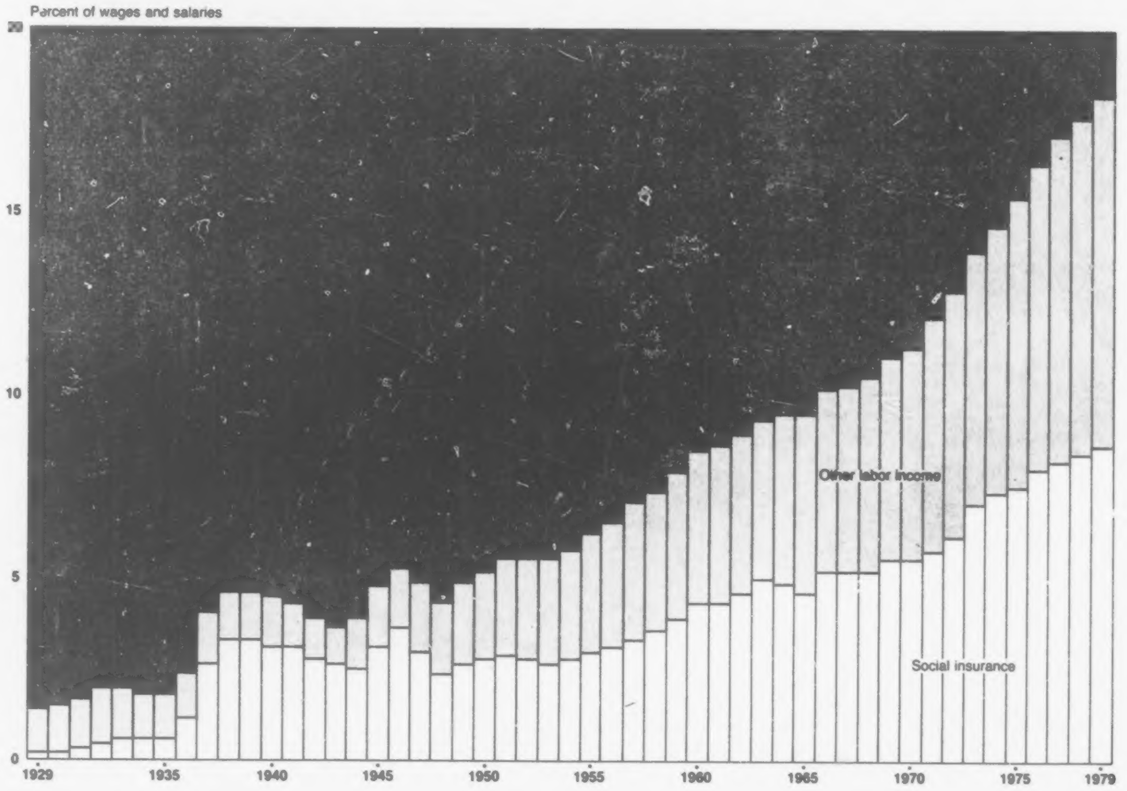
(Computed from United States Department of Commerce Data.)

Industry group	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
All industries	5.4	4.9	4.4	4.9	5.3	5.6	5.6	5.6	5.9	6.3	6.6	7.2	7.4	8.0	8.5	8.6	9.1
Agriculture, forestry, and fisheries	0.5	0.5	0.5	0.5	0.6	0.9	1.0	1.1	1.3	1.9	2.0	2.3	4.0	4.3	4.7	4.8	5.2
Mining	4.8	5.8	6.7	7.2	9.4	9.5	9.2	9.7	10.0	10.5	11.0	10.8	10.9	11.7	12.2	12.8	13.6
Contract construction	5.7	5.8	5.7	5.7	5.9	5.9	5.8	6.0	6.4	6.5	6.5	7.0	5.6	6.6	7.0	7.5	7.7
Manufacturing	4.9	5.1	4.9	5.4	6.6	7.3	7.3	7.3	7.9	8.3	8.8	9.4	9.9	10.3	10.8	10.9	11.5
Transportation	6.1	7.4	6.1	6.4	6.6	6.5	6.7	6.7	7.0	7.4	7.8	8.3	8.1	9.2	9.6	9.9	10.1
Communication	8.9	9.1	8.8	9.1	10.1	10.0	9.8	9.5	9.5	8.9	8.8	9.1	9.6	10.9	11.1	11.5	12.2
Electric, gas, and sanitary services	8.7	8.2	7.8	8.2	9.2	10.2	10.0	9.4	10.3	10.6	11.3	11.7	12.8	12.7	12.6	13.4	13.3
Wholesale and retail trade	3.4	3.5	3.1	3.3	3.8	3.9	3.8	3.8	4.1	4.3	4.5	5.0	5.2	5.9	6.4	6.8	7.4
Finance, insurance, and real estate	5.3	5.1	5.4	5.8	6.1	6.4	6.7	6.9	7.4	7.5	7.6	8.0	8.5	9.3	9.6	9.6	10.4
Services	2.3	2.2	2.1	2.2	2.5	2.9	2.9	3.0	3.2	3.3	3.3	3.6	3.8	4.6	5.1	5.3	5.7
Government and government enterprises	9.6	6.7	3.9	5.7	4.2	4.0	3.9	3.4	3.4	4.1	4.8	5.9	6.3	6.7	7.2	7.5	7.5
All private enterprises	4.4	4.7	4.4	4.7	5.5	6.0	6.0	6.0	6.4	6.7	7.0	7.5	7.6	8.3	8.7	8.9	9.4

Industry group	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
All industries	9.4	9.5	9.5	10.3	10.4	10.7	11.1	11.5	12.1	13.0	14.0	14.7	15.5	16.4	17.1	17.6	18.2
Agriculture, forestry, and fisheries	5.6	5.6	5.6	6.5	6.8	7.0	7.4	7.4	8.0	8.5	9.4	9.9	10.7	12.9	11.9	12.8	12.8
Mining	13.3	13.5	12.8	14.0	14.5	14.6	14.9	15.3	15.6	16.1	17.3	17.7	18.5	19.0	19.6	19.8	20.4
Contract construction	8.5	8.2	8.5	9.0	9.0	9.5	9.2	9.9	10.1	10.9	12.1	12.3	12.5	13.2	13.9	14.3	14.6
Manufacturing	11.7	11.8	12.0	12.7	12.8	13.3	14.0	14.4	15.3	16.2	17.4	18.3	19.6	20.5	21.3	21.8	22.5
Transportation	10.4	10.4	10.6	11.4	11.4	12.2	11.6	12.7	13.3	14.6	14.9	17.3	18.7	19.3	19.7	20.0	20.5
Communication	13.0	15.2	18.2	18.6	19.2	19.9	19.5	24.0	26.0	28.3	27.5	27.1	28.9	30.1	30.0	30.4	31.5
Electric, gas, and sanitary services	13.5	14.1	14.4	15.2	14.9	15.7	15.2	16.8	17.7	18.7	19.1	20.3	22.6	23.5	23.9	24.4	25.4
Wholesale and retail trade	7.8	7.7	7.6	8.3	8.4	8.7	9.2	9.4	9.9	10.8	11.8	11.6	11.9	13.1	13.6	13.9	14.3
Finance, insurance, and real estate	11.0	11.0	11.4	12.4	12.5	13.0	12.6	13.3	14.2	15.6	16.5	16.7	17.8	18.4	19.0	19.3	19.9
Services	6.2	6.1	6.2	6.9	7.1	7.1	7.5	7.9	8.5	9.5	10.6	10.9	11.5	11.9	13.3	13.0	13.5
Government and government enterprises	7.9	8.1	7.9	8.6	9.1	9.1	9.7	10.0	10.5	11.0	12.0	13.1	14.2	15.4	16.1	16.6	17.8
All private enterprises	9.8	9.8	9.9	10.7	10.7	11.1	11.5	11.9	12.6	13.6	14.6	15.1	15.9	16.7	17.4	17.8	18.3

Chart 6.

Supplements to Wages and Salaries as Percent of Wages and Salaries, 1929-79.
(United States Department of Commerce Data.)



Chairman Pickle. Does that complete your statement, Mr. Alexander?

Mr. Alexander. That completes my statement.

Mr. Romig and I will be glad to answer questions about the chamber's questionnaire and will be glad to provide specific responses to your specific questions.

Chairman Pickle. Let me ask Mr. Swain, are you prepared to make your statement? If so, then proceed, and afterward we will talk to the panel as a whole.

STATEMENT OF FRANK S. SWAIN, CHIEF COUNSEL, OFFICE OF ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION

Mr. Swain. Yes, Mr. Chairman.

Chairman Pickle. Mr. Swain is chief counsel, Office of Advocacy of the U.S. Small Business Administration. We are glad to have you, Mr. Swain.

Mr. Swain. Thank you, Mr. Chairman, members of the committee. I certainly appreciate the invitation to the Office of Advocacy to participate in these very important hearings.

As you may know, the Office of Advocacy is statutorially charged with being, within Government, policy spokesman for small business responsible for assessing the impact of Federal policies and proposals on the small business community.

With your permission, Mr. Chairman, I would like to very briefly summarize my statement so that you may get to any questions.

Chairman Pickle. Your entire statement will be included in the record and that applies also to Mr. Alexander and any statement you might want to make, also Mr. Romig.

Mr. Swain. I would like to discuss several issues. First of all, I think it is important to make sure that it is on the record that employee benefits are important to small business owners. I think sometimes in a discussion of employee benefits there is a perception that small businesses don't offer employee benefits, perhaps because they are too stingy or uninterested. In my 3 years as chief counsel for Advocacy and several other years working with the small business community, I assure you that nothing could be further from the truth.

Small business employers are very concerned about the ability to offer employee benefits. Small businesses are the job creators. They employ two out of three first-time workers in the work force. It is a tremendous cost to hire a new worker, have him or her work for a business for several months or a few years then move to some other business that might have a larger or more lucrative employee benefit package. The ability of a small business employer to provide its employees and employees' families various fringe benefit options is extraordinarily important.

Second, I would like to discuss the differing prevalence of fringe benefits in large and small firms. Simply put, a large business is very apt to have both health and pension coverage for their workers; a small firm very much less so. Our statement provides some specifics that generally track with the figures that were provided by Mr. Salisbury of the Employee Benefit Research Institute. Basically, surveys indicate that if one works for a firm with fewer than

25 employees, one has about a one out of five chance of being covered by pension benefits, and about a one out of three chance of being covered by health benefits.

If you work for a firm that has more than 500 employees, you have about a 9 out of 10 chance of being covered by pension benefits and about the same opportunity of being covered by health benefits.

In other words, as figures in our testimony indicate, small business employers are not nearly as likely as large employers to have either pension coverage or health coverage, although small employers are more likely to provide health insurance than pension coverage.

Levels of health and pension coverage also vary significantly by industry. Both pension and health care coverage is greatest in the manufacturing and finance industries, while coverage is lowest in the trade, service and construction sectors—all sectors, I might add, that are rapidly growing in our economy.

The characteristics of pension and health care plans differ significantly in large and small firms. Small firms are more likely to have defined contributions than defined benefit plans. Pension benefits tend to vest earlier for workers in small businesses largely due to the greater likelihood that the small firm has established a defined contribution plan.

In the area of health care cost containment, small businesses are leading the way in attempts to cut down the costs containment, small businesses of their plans. We noted in the testimony several cost saving initiatives that we find very frequently in small business health care plans.

What are the reasons for a lower level of coverage in small businesses as opposed to larger firms?

The first and foremost reason is less profitability in small firms. Small firms can't afford many times very costly level of benefits necessary to sustain pension and health care plans in particular. Various surveys have continued to isolate this as the No. 1 basic factor, small firm profitability. There are several other significant factors.

In addition to the issue of profitability, I would like to mention the fact that the benefit costs of health and pension plans are oftentimes very great for small firms. Small firms generally face higher health insurance premiums than larger firms because they are unable to spread the risks across as many employees.

Pension benefits also cost more per worker in small firms. For example, pension costs per worker, in one survey that we have cited in the testimony, average $1,080 per worker in firms with 10 or fewer employees; but in firms with between 500 and a thousand employees the average cost per worker is $574. Clearly there are some tremendous economies of scale in providing pension and health care benefits.

Administrative costs and start-up costs, as a result of the complexity of the law and the specific forms required to be filed, are also a tremendous, largely fixed burden for small firms.

Various efforts to regulate the pension and benefit area I think have been largely counterproductive in their attempts to enhance the ability of small firms to offer more generous pension and health care benefits. I cite simply the 1980 Multiemployer Pension Plan Amendments Act which many people felt would solve some significant problems in that particular category of benefit. I think, that at least as far as the small business community is concerned, in the 4 years since that act has been effective, the cure has been far worse than the disease.

Finally, I think it bears mentioning that many times small businesses employ a large proportion of younger workers and part-time workers and the workers themselves may well express a preference for larger take-home pay rather than having a larger amount of the compensation deferred in various benefit packages.

Finally, I would like to mention just one factor. We don't come here as experts on tax or revenue losses. We are not responding in our statement to any specific proposals that may be before the committee now or in the future. We are simply here to stress the fact that the proposals to expand the taxable wage base by including fringe benefits are likely to have a differential impact on smaller firms as is almost any other proposal in the tax and fringe benefit area.

It is likely to have very much of a differential impact on small firms versus larger firms. This is because small firms are generally more labor-intensive than large firms even within the same industry, and increased taxes on labor will increase these firms' costs over more capital intensive competitors.

I think it is clear that the Congress cannot legislate more coverage of workers in small firms since lack of sufficient profitability is the major factor influencing an employer's decision to provide employee benefits.

I think it is equally clear that small business' ability to offer various pension and profit-sharing options can certainly be legislated away by the Congress, either directly or indirectly deterred by increasing cumbersome administrative and tax burdens.

Our bottom line is simply that we hope that the committee, in looking at this very important issue this year and the future, pays very specific attention to the relative costs and impact of various policy proposals on small firms.

We think that this is tremendously important.

After all, small firms do represent over 4 million employers and employ over half of the private sector work force. It is a key force in our economy. Too many times the Congress takes action without fully realizing its impact on the smaller business sector.

Thank you very much for your invitation, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Swain.

[The prepared statement follows:]

STATEMENT OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION

Thank you for providing me the opportunity to speak with you today. Employee benefit programs are an important concern of small businesses. Today, I would like to highlight their significance, as well as illustrate and explain the differences in benefit coverage in small and large firms. I believe that an awareness of the different picture for small and large businesses is essential to informed and rational decisionmaking in this area.

I. THE SIGNIFICANCE OF EMPLOYEE BENEFITS TO SMALL EMPLOYERS

Fringe benefits and other payroll-related costs are of extreme importance to small businesses due to the relative labor intensity of smaller firms. Payroll cost issues were cited as one of the top 10 priorities in the June 1984 National Small Business Issues Conference.

The importance of employee benefit plans to small business is obvious. A small business's ability to offer a worker a package of compensation, including wages and benefits, enables it to compete with larger firms for the most qualified employees. Given two firms offering a prospective employee an equal wage but unequal benefit plans, it is difficult to imagine a worker selecting the job with the less attractive benefit option. The ability of a small business to attract and maintain a quality workforce enables it to effectively compete in the market place with larger enterprises in the production of goods and services.

However, there are dramatic differences in the level of benefits offered by small and large firms. There are several explanations for this tendency, which I will discuss, but the unambiguous conclusion is that small business does not stand on equal footing with large business in its ability to provide fringe benefits.

II. THE EXTENT AND NATURE OF EMPLOYEE BENEFIT PROGRAMS VARY GREATLY WITH FIRM SIZE

Studies reveal that pension and health care coverage for workers increase dramatically with a business' size.[1] For example, in the area of pension benefits, in 1979, only 20% of workers in firms employing 1-24 employees had pension coverage, as compared to 46% in firms employing 25-99 workers and 70% in firms employing 100-499 employees. In businesses employing over 500 employees, approximately 89% of the workers were covered by pension plans (Table 1). In the very largest businesses—those employing over 2500 employees—pension coverage approached 96% in 1977.

While most businesses are more likely to offer health care benefits than retirement plans, the incidence of group health insurance also increases with establishment size. Census data from 1979 indicates that coverage ranges from 36% in the smallest firms (1-24 workers) to 86% in firms employing over 500 workers. For a more detailed breakdown of firm size and health care coverage, I refer you to Table 2 which is appended to my statement.

Levels of health and pension coverage also vary significantly by industry. Both pension and health care coverage is greatest in the manufacturing (durable goods) and finance industries, while coverage is the lowest in the trade, services and construction sectors. While a large proportion of the firms in low-coverage sectors are small businesses, wage level and unionization affect the extent of benefit coverage in different industries. Firms in low coverage sectors tend to be non-unionized and employ a high proportion of low wage employees. Studies reveal that pension coverage is greater when an establishment is unionized, regardless of its size. Both health and pension coverage increase with the level of wages. However, an analysis of the confounding variables of size and wage level indicates that increases in establishment size are more influential than increases in wage level in determining the extent of pension coverage in different industries.[2]

The characteristics of pension and health care plans also differ significantly in large and small businesses. Small firms are more likely to have defined contribution than defined benefit plans. Pension benefits tend to vest earlier for workers in small businesses largely due to the greater likelihood that the small firm has established a defined contribution plan.[3] Small firms are most likely to have retirement benefits funded by profit sharing plans. As might be expected, few small firms offer more than one retirement plan. Long-term disability benefits are another rare feature in small business pensions.

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[1] See James Bell and Associates, Inc., "Coverage Characteristics, Administration and Costs of Pension and Health Care Benefits in Small Business" (1984). This study was conducted for the Office of Advocacy and provides detailed analysis of the extent and nature of employee benefits in small firms. The study relies on findings from national aggregate data analysis, regional surveys of small businesses, and on-site case studies and telephone discussions with small employers.

[2] See Bell, "Coverage, Characteristics, Administration and Costs of Pension and Health Care Benefits in Small Business," pp. 23-24.

[3] In small firms, over 40 percent of workers with coverage need less than 5 years until the vesting period is met. This is compared to 24 percent of covered workers in the larger firms. In the smallest firms, 20 percent of the workers actually have benefits vested within one year of employment.

The scope of health benefit coverage is also narrower in small businesses. Workers covered by small health benefit plans are less likely to have family coverage than workers covered by large plans. The types of benefits also tend to be less generous in small firms, particularly in the areas of dental and maternity benefits. Employee contributions to health plans are commonplace in small firms. Deductibles and co-insurance provisions are also prevalent features in small business health benefit plans.[4]

III. REASONS FOR LOWER BENEFIT LEVELS

Several factors contribute to the lower incidence and narrower scope of employee benefits in small-sized businesses. Firm profitability, cost of benefits and plan administration, regulatory complexity and employee preferences all influence small firm's decision to establish a benefit program. A recent study of small employers without pension plans reveals that lack of sufficient profitability is the dominant reason for not establishing a pension plan.[5] Corresponding to a small firms' lower profits is the lesser value of the tax deduction available for qualified employer pension plans and group health insurance programs.

The benefit costs of health and pension plans are greater for small employers. Smaller firms generally face higher health insurance premiums than larger firms (for the same coverage) because they are unable to spread risk across as many employees. In small firms, a few very high claims in a given year will increase premiums for the whole group, whereas larger firms can spread risk and avoid fluctuations in price. Pension benefits also cost more per worker in small firms. For example, in 1977 pension costs per worker averaged $1,080 in firms with less than 10 employees. This is compared to a cost of $574 per worker in firms employing between 500 and 1000 employees.[6] A component of the cost differential is the cost of administering the pension plan.

There is ample evidence of decreasing administrative costs as firm size increases.[7] One study revealed that the administrative expenses per participant in small pension plans were seven times greater than for large plans. Research also indicates that government regulation has increased the administrative costs of small plans. A study of the effects of ERISA on administrative costs reveals an increase of 72% for plans with less than 100 participants. Another study shows that the incremental costs of ERISA for the smallest employers studied were nearly seven times as great as the average incremental cost of the ten largest employers studied.

Start-up costs present a further impediment to the establishment of small business benefit plans. Small employers must obtain out-of-house consultants to determine if a benefit program is advisable as well as to design a workable benefit plan. Small firms report start-up costs in the $2,000 to $5,000 range. Many have estimated costs of $1500 to amend retirement plans to comply with alternations in the law subsequent to a plan's initiation.[8]

Government regulation is another factor influencing the provision of benefits in small firms. As previously discussed, there is evidence that ERISA has increased administrative costs and added further costs associated with amending plans to keep pace with frequent changes in the law. The Multiemployer Pension Plan Amendments Act of 1980 (MPPAA), which was intended to eliminate problems that impeded the maintenance and growth of multiemployer plans, has had the unanticipated effect of discouraging such plan formation. The Act's withdrawal liability provisions pose a particular problem for small firms because the withdrawal assessments can exceed the business' net worth. The events that can trigger withdrawal liabilities, such as the sale of the business or loss of business lease, are commonplace among small businesses. The Act has tended to impede the transferability of small businesses and discouraged small employers from participating in multiemployer plans.

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[4] This is particularly true in firms employing 26–100 workers. In 1982, 92 percent had deductibles and 91 percent had coinsurance provisions.

[5] See Bell, "Coverage, Characteristics, Administration and Costs of Pension and Health Care Benefits in Small Business," p. 77, for a more detailed breakdown of pension costs per worker by establishment size.

[6] See Bell, "Coverage, Characteristics, Administration and Costs of Pension and Health Care Benefits in Small Business," pp. 34–36.

[7] See Bell, Ibid., pp. 2–4, reviewing a number of studies on the administrative costs of small retirement plans and the effects of ERISA on the costs of small plans.

[8] Ibid., p. 109 (discussing start-up costs) and p. 93 (discussing plan amendment costs).

The composition of a small firm's workforce is a final factor influencing the extent of benefit coverage. Compared to large businesses, small businesses hire more younger workers, pay lower salaries to a larger proportion of workers, hire more workers on a part-time basis, hire more "secondary workers" (i.e., second wage earners in a family with two or more workers). Younger workers, or those with low wages, often prefer a higher salary to more comprehensive benefits. Relatively new and part time workers may not be eligible under company benefit plans where they exist. All of these factors tend to lower the proportion of total compensation going to fringe benefits.

Conversely, large businesses hire a larger proportion of prime age workers, hire more workers on a full-time basis, pay higher salaries to a greater proportion of workers, and employ more "primary workers" (i.e., individuals who earn most of a family income). Workers in higher tax brackets are more likely to prefer a greater proportion of compensation in the form of fringe benefits. All of these factors tend to increase the proportion of total compensation going to fringe benefits. Not surprisingly, larger businesses, on average, put more dollars per worker into fringe benefits packages, and pay a larger proportion of total compensation in the form of fringe benefits.

IV. COSTS MAY INHIBIT FUTURE EXPANSION OF EMPLOYEE BENEFITS IN SMALL FIRMS

Due to the high levels of benefit coverage existing in large firms today, any significant expansion of benefit programs is likely to occur in small businesses. As small employers continue to create a disproptionate share of new jobs,[9] the growth of benefit plans among small employers is likely to be even greater. However, because small employers have cited insufficient profitability and cost as major factors in the decision to establish pension benefits, the need to reduce the costs to small firms of providing benefits may be necessary to stimulate benefit growth.

Rising health care costs present a significant impediment to the expansion of health insurance coverage in small firms. Small employers have reported spiraling premium costs as great as 15% to 30% a year, depending on the firm's size and location. In response to increasing costs, small employers have been forced to change insurance carriers and basic provisions of plans. Increasingly, firms are moving away from high option coverage to standard coverage; asking employees to share in the costs of coverage by making monthly contributions to the cost of coverage; adjusting plans to include higher deductibles; and instituting co-insurance features, under which the employee pays some percentage of claims (e.g, 20% of cost above a certain level).

Whether these measures will prove effective in curbing costs is still uncertain.

V. IMPLICATIONS OF TAXING EMPLOYEE BENEFITS TO SMALL BUSINESSES

There is no clear cut data indicating the effect of a tax cap on the health insurance premiums of small firms. However, our knowledge of the small business community suggests both potential positive and negative consequences depending on firm size, industry and the level at which the tax cap is placed. On one hand, a tax cap that was uniform across all businesses, regardless of size, could discriminate against smaller firms which are unable to get as much benefit coverage per dollar. Small employers pay more than large firms to obtain the identical coverage and a tax cap at a particular level might compel small employers to limit the comprehensiveness of existing health care packages. Employees may have to purchase supplemental health insurance with after-tax dollars. Supplemental insurance would be most costly to low-wage workers who are found more frequently in small firms. Additionally, the tax-cap could discourage small firms from hiring older workers, whose health care costs are predictably higher and drive up costs for the entire group.

On the other hand, taxing insurance payments above a certain level could reduce the differential in health benefits provided by small and large businesses. Such a limit could strengthen small firms' ability to complete with larger industries for more productive workers. In addition, a tax-cap could result in a redistributive effect in favor of lower income employees—who tend to work in small businesses—as higher paid workers will be taxed on benefits at progressively higher rates. The

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[9] A study conducted by David Birch reveals that firms with fewer than 20 employees, representing approximately 33 percent of total employment, created 66 percent of the net new jobs in the United States from 1969-1976. In 1980-1982, firms employing less than 100 workers were responsible for creating 100 percent of the net new jobs.

Office of Advocacy will continue to review the proposed measure to determine the most likely effects of a tax-cap on small business benefit programs.

Proposals to expand the taxable wage base by including fringe benefits are likely to have a differential impact on smaller firms. This is because small firms are generally more labor intensive than large firms within the same industry, and increased taxes on labor will increase these firms' costs over more capital intensive competitors. In the manufacturing and mining industries, for example, small firms rely more heavily on labor in production than do large firms.[10]

The payroll tax burden on small firms in general will likely become even greater as the workforce continues to shift from large industry into the service sector and small businesses continue to provide an increased portion of our nation's new jobs. The schedule of increased payroll tax rates established by the 1983 Social Security Amendments will pose an additional payroll tax burden on small businesses in the future.

I have highlighted some of the important differences between large and small business in providing employment and compensation to workers. I believe that an awareness of small businesses' impaired ability to provide employee benefits is highly relevant to the development of policy and legislation in this area. I would be pleased to answer any questions you may have.

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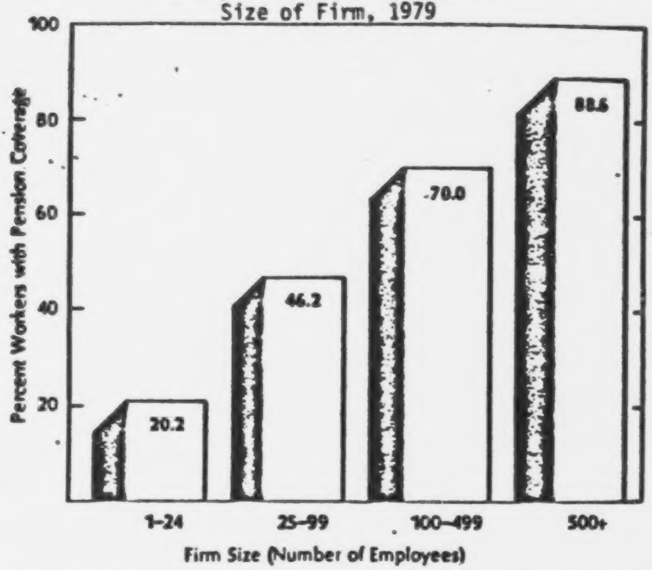
[10] A study conducted for the Office of Advocacy by Steven Lustgarten. "Firm Size and Productivity" (1982), found that the contribution of labor to total output in manufacturing firms, was approximately 57 percent for firms with under 20 employees as compared to approximately 49 percent for firms with over 500 employees. Lustgarten relied on Bureau of the Census data from 1947-1972.

TABLE 1

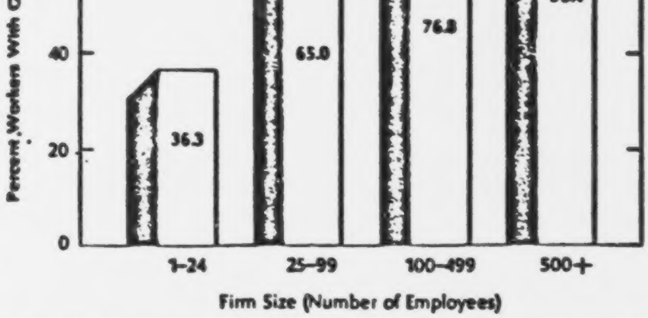
Pension Coverage of Wage and
Salary Workers by Employment
Size of Firm, 1979



Source: U.S. Department of Commerce, Bureau of the Census, "Current Population Survey" data, March 1979 and May 1979.

TABLE 2

Group Health Insurance Coverage of
Wage and Salary Workers
by Employment Size of Firm, 1979



Source: U.S. Department of Commerce, Bureau of the Census, "Current Population Survey" data, March 1979 and May 1979.

Chairman PICKLE. I appreciate the testimony of each of you. I find it to be exceedingly helpful. Your charts and figures, your factual analyses, Mr. Salisbury, extremely important to our committee as we consider the overall approach.

Mr. Alexander, I appreciate your comments which were rolled into a nice, pleasant package, but I want to read your testimony in greater detail. I appreciate your statement about small business.

Let me ask you as a group, its true that employee benefits are growing, perhaps as much as 3 percent up to around 17 or 18 percent, or you can go even higher than that depending on the approach you take. Do you anticipate that employee benefits will continue to grow in a similar fashion in the next 5 years, 3 to 5 years?

Mr. ROMIG. Mr. Pickle, in our historical survey, copies of which we supplied the committee, if you will turn to page 23, you will see that the cost data that we show for the period of 1951 through 1979 show that about 1977 or 1978 there was an apparent slowing-down in what employers are spending for employee benefits, and that this trend continues, so it appears from the data that we have collected so far that the growth potential has slowed.

It is continuing but has slowed measurably.

Mr. SALISBURY. Mr. Pickle, if I could add to that, I think you have got a balance factor. For those employers who are spending the most, they are now trying to spend no more or less. As a result, pension contributions are dropping at the largest companies, and they are going through major changes as described by the Department of Health and Human Services yesterday, to reduce their health care expenditures and all.

On the other hand, in terms of Mr. Swain's comment, there are still many businesses that do not have employee benefits, and if they go from having no employee benefits to next year spending 4 or 5 percent of wages and salaries on benefits, the total amount that all of these numbers are going to show is going to be going up, and so really I urge the staff and the committee to look at these two different issues.

One issue is, Are those who are already spending a lot likely to continue spending more? If you believe any of the surveys of labor or management, the answer is no.

On the other hand, will spending continue to grow if the tax incentives are effective in having employers that don't provide employee health now provide it and other things, the gross numbers are going to grow, and if you will, in the terms of some of the specific questions of yesterday, the FICA tax base erosion, to that degree, will continue, but it will be because of an expansion of the protection more than it will be because those who already have are spending more.

Chairman PICKLE. I take it that you are saying that the charts and the trend shows that there is a leveling-off on employee benefits, and therefore there is such a leveling-off that we don't need to do anything.

The program, and the administration of it, will take care of itself.

Mr. SALISBURY. I am not suggesting that. To take an example, if you take the charts from the Social Security Administration yesterday in their testimony, those charts, because they simply use averages, would imply to you that everyone every year is spending more on their benefit programs. That is not the case.

Even if tomorrow you were to take that chart and change the law, and say we are going to put a cap, a percentage cap, on what any one employer can spend, you are still going to see the line go up because employers that currently don't have programs are going to put them into effect.

The Social Security Administration chart yesterday indicated that on the average all employers are spending approximately 16.8 percent of compensation on a combination of Social Security, pensions, health and other fringe benefits. Let's say you were to cap it and say nobody can ever spend more than 16.8 percent. There are still hundreds of thousand of businesses out there that are spending so far less than 16.8 percent that your growth, the absolute growth, is still going to continue.

Now, you get something for that. You get pension protection. You get health protection. You get life insurance protection, but it is that balance factor. It doesn't say you shouldn't do anything. It does say that how you draw lines has to be done with great care.

Chairman PICKLE. I repeat again, you indicate to me that the chart will not continue to go up if we just let things alone, but that it will go up some.

Mr. SALISBURY. It will not go up as fast.

Chairman PICKLE. You don't think it will go up in the same percentage what it has over the last 20 years?

Mr. SALISBURY. Not as fast, no.

Chairman PICKLE. All right.

Now, is there any way to handle the equity issue? How would you handle this, given the fact that, if there are two approaches to take, as you say, Mr. Salisbury, there are already those who are covered and receive the benefits, and then there are also all those people out there that are not covered, who do not get employee benefits; what is equity? Where is the equity?

How does the Congress address the problem to the small business individual or the person not covered? How does he get relief or how does he get something out of this?

Mr. SALISBURY. I will answer your question with a question.

The charts I showed you indicate that even when you include small businesses, over 80 percent of all working Americans today have employer-provided health insurance. Do we cut back on the 80 percent in order to provide equity for the 20 percent, if the result of that is then that in order to provide for basic needs we have to put into effect a national health insurance program or something else?

Chairman PICKLE. You are not recommending that we cut back on that 80 percent. My question is, what do you do for that 20 percent? Your chart shows somewhere between 4 and 18 percent.

Mr. SALISBURY. I can direct you, for lack of a better example, to a study that was mandated by the Carter administration, a Carter-appointed President's Commission on Pension Policy.

The conclusion of that broadly-based Commission was that the only way to really get broad-based usage in the small business sector was to expand the tax incentive, to provide an employer with the equivalent of a tax credit rather than simply a tax deduction, if you wanted it to still be a voluntary system. That is expensive.

Chairman **Pickle**. That would be a loss to the Treasury?

Mr. **Salisbury**. That is expensive.

Mr. **Alexander**. That certainly would be a loss to the treasury.

Mr. Chairman, the Chamber doesn't quite agree with Dallas Salisbury's prediction, qualified as it was, of further growth, and perhaps an implication that further growth in the tax favored employee benefit area might be at the same rate in the future that it has been in the past.

I am no statistician. It would just seem to be very difficult to achieve, to me, if 80 percent were already covered at the optimum level, and only 20 percent were left.

If all 20 percent immediately decided to obtain coverage at the optimum level, perhaps there would be rather surprising growth in the particular year, but there would be zero growth the following year, so I don't quite understand the projection. That shows I am no statistician, but I do understand reality and the realities are that the Chamber's surveys show a definite decline in the growth rate.

There has been an absolute decline in certain elements, as Mr. Salisbury pointed out. But how are we going to help small business? I think you have just ruled out making everybody equal by reduction—making me the same height as Congressman Duncan by cutting off his legs up to the knees.

A better way would be to give me elevator shoes, and I suggest the better way is to help small business rather than hurt other small business.

Mr. Swain can best speak to this.

Mr. **Swain**. Let me say, Mr. Chairman, that you basically have two types of small businesses. Eighty percent of the businesses in this country have static levels of employment. They will have 20 employees today. They may have 21 next year. They may have had 19 last year.

Whether they offer a pension or health plan I think has less to do with anything else than how much money they are making. One might ask how can you reconcile the fact that half of the workers in the country work for small business, but Mr. Salisbury says that 80 percent of all American workers are covered by health plans.

It is very simple to reconcile. A lot of the people that work for small business are so-called secondary or tertiary wage earners who may be covered under a family member's plan, and so the fact that a lot of small businesses don't offer various benefit levels is not necessarily a bad thing.

I think it is more a reflection of the demography of the work force and the amount of money that small businesses are making. That is true for 80 percent of the small businesses.

All of the figures you hear about job generation, that small businesses are creating new jobs and creating innovations, are all quite accurate. Almost all of those jobs, in any given year, are created by a very small number of small businesses, maybe 15 or 20 percent of the small businesses.

It is those businesses that are actively growing or shrinking; they are competing for employees, frequently highly professional or highly technical employees. These small businesses are competing for employees against large firms and large universities which many times offer benefit levels that are very attractive.

Those small firms have to have the options to offer similar benefit levels in order to sustain their growth which we all depend on? I would suggest that there is very little that Congress can do to mandate broader pension coverage from an employer who doesn't have it now except by providing some incentive. Obviously, whether those incentives are provided or not is a revenue question. On the other hand, the Congress can do a whole lot to discourage those quickly growing small firms from being able to compete by further increasing the administrative or the regulatory——

Chairman PICKLE. The Congress has had no intention, so far as I know, of taking away some of the employee benefits. You have, each of you, both inferred the fact that you ought not to take away in order to help this other group. We are not trying to take it. You are just not going to put words in our mouth that we are going to slow down or take away the benefits.

You raised the question, how far can it grow? You indicated it is leveled off and won't grow any more. If that is so, should we try to arrive at a cap or a percentage? I presume none of you want that, but just trust to the Lord that it won't grow any, and we can all go home happy. We could do that, but then that still leaves you in the inequitable status of the person who gets none of these employee benefits. The committee is simply trying to look at the overall question.

Will it continue to grow? And I have to say that it will continue to grow.

I hear what you tell me, but I look at the charts, and the practice of the employers of the country, the large employers, and I think the average employer would go up to 20, 25, and 30 percent if they thought they would get a tax deduction for him.

I don't think there would be any limit, almost. You could say that such levels would be reasonable and realistic, but I have not seen the growth slow down. I know that you like these credits, so I have to say that we have to concern ourselves about their continued growth.

Also, we know if you try to help broaden benefit coverage, and say we will give you a credit or a tax deduction to do it, that costs the Treasury a bundle. We don't know what the answer is. But, I don't think the answer lies in just blissfully saying that there is no need to worry about imposing a cap, or controls, or some kind of standards, because it is becoming a serious problem.

I was particularly impressed, Mr. Salisbury, with your comments, and I want to give myself another minute.

You said if we did lose $50 billion in revenue this past year, that that would be offset perhaps by the payment in future years of deferrals of income.

Mr. SALISBURY. A major portion, 60 percent.

Chairman PICKLE. So you are saying that is not actually lost to the Treasury. It is deferred and Treasury will get it in years to come.

I found that interesting. I don't know whether I accept that analysis. I want to make one other point. I recognize that the Government ought not to take the position we are going to run these programs because quite often on these benefits we run them less efficiently and effectively than private enterprise.

If we do not allow for employee benefits then Government in turn—since the Government has this responsibility—will inherit those responsibilities. This I think would cost us more. So you have to ask yourself who can do it best. But there still has to be a level of how often and how far could we go in this if we are going to protect the tax base. So I appreciate your testimony and perhaps we will have a chance to come back as we ask further questions on it.

[The following was subsequently received for the record:]

ANSWERS TO QUESTIONS ASKED BY CONGRESSMAN PICKLE REGARDING EMPLOYEE BENEFITS AND THE TAX CODE, SUBMITTED BY THE EMPLOYEE BENEFIT RESEARCH INSTITUTE

1. We need to understand the relationship between private pensions, Social Security and individual effort plans such as IRAs. We need to understand what happens to one of these when a change is made in one of the others.

Social Security, employer-sponsored pensions and Individual Retirement Accounts (IRAs) are complementary, working together to assure retirement incomes. They are not perfect substitutes in terms of benefit delivery, but change in one would effect public pressures for, support for, and confidence in the others.

Social Security provides a floor of protection on a redistributional basis, with lower earners receiving proportionally greater benefits. Many of those who rely most heavily on Social Security do not have high enough incomes to allow savings, and their work is such that they are unlikely to have employer sponsored retirement plans. Social Security is a pay as you go program. Research indicates that it has no effect, or a negative effect, on aggregate national savings.

Employer-sponsored plans provide another form of "forced" savings that represents a tier of income above Social Security. Among employers with more than 250 employees these programs are almost universal. Among smaller employers they are not. For a significant portion of the population these advance funded programs represent their only real savings. As a result, research indicates that each dollar contributed to a pension increases aggregate national savings by at least 35 cents.

IRAs are a vehicle for voluntary savings. They are used by 17 million persons as compared to over 50 million with pension coverage. Over 13 million IRA holders also have pension coverage.

There are also differences in what these programs provide, or must provide, under current law. These differences affect the degree to which employer sponsored plans and IRAs "compliment" Social Security in terms of retirement income provision.

Social Security only pays benefits as a stream of monthly benefits.

Employer sponsored plans are of two types: (1) those that only pay benefits as a stream of monthly benefits—most defined benefit plans and some defined contribution plans such as TIAA-CREF—and (2) those that make one time "lump-sum" payments at change of employment or at retirement age and thus may or may not produce retirement income—most defined contribution plans.

IRAs allow the money to be withdrawn at any time with the payment of a small payment and after age 59 and ½ allow it to be removed as a lump-sum.

2. What is the relationship between private health plans and Medicare? If private health plans are taxed to help finance Medicare now, will it eventually result in greater demands on the Medicare system in the future?

Employer sponsored health programs provide risk production to most workers and their dependents. Research indicates that taxation of these programs might lead to a reduction in coverage. This in turn could produce significant pressure for a government program to complement present health programs for the poor (Medicaid) and the elderly (Medicare). Employers also increasingly are providing health insurance for retirees to supplement Medicare. Were these programs eliminated it could increase long-term costs of Medicare due to a reduction in wellness.

Proposals for major tax reform therefore, need to be carefully scrutinized. To the degree the full taxation of these programs as income rests on the assumption that they will continue to exist, research indicates that for millions of workers, they will not. Further, taxation could lead to an unintended age discrimination effect if health insurance were given an income value equal to the benefit provided, which would increase dramatically with age.

3. What are the appropriate employee benefits that should enjoy favorable tax treatment? What level of tax exempt or tax deferred benefits is acceptable in light of the Federal Government's revenue needs?

Employee benefits should enjoy favorable tax treatment if they provide a benefit that the government would otherwise be required by public sentiment to provide; if it is provided more cost effectively by the employer than it could be by the government; if it serves a human resources objective that is to the advantage of the government and can most effectively be achieved through the employer; if it serves an economic advantage to the government that can be achieved most effectively through the employer; if it achieves a social objective such as allowing women to more readily enter the workforce and can most effectively be provided through the employer; if it allows U.S. employers to more effectively compete internationally; etc.

Different employee benefits test vary differently against these criteria. For an analysis of such a question benefits should be clearly differentiated and can be classified into at least nine categories:

(1) legally required benefits (including employer contributions to Social Security, Medicare, unemployment insurance and workers' compensation insurance);

(2) discretionary benefits that are fully taxable (primarily, payment for time not worked);

(3) discretionary benefits that provide retirement income as a stream of payments and for which taxes are deferred until benefits are received (including employer contributions to defined benefit pension plans and to defined contribution plans which require payment in the form of an annuity);

(4) discretionary benefits that insure the employee against financial risks and are tax exempt (including employer contributions to health, life, and disability insurance plans);

(5) discretionary benefits that provide for the deferral of salary until termination of employment, generally pay benefits as a lump sum, and for which taxes are deferred until benefits are received (including contributions to some profit sharing plans, to money purchase plans and ESOPs);

(6) discretionary benefits that provide for the deferral of salary until special needs arise (loans and hardship), or until termination of employment, generally pay benefits as a lump sum, and for which taxes are deferred until benefits are received (including contributions to some profit sharing plans, thrift-savings plans, and salary reduction plans);

(7) discretionary "reimbursement account" benefits programs that have been legally allowed since 1978 which allow employees to have reimbursement accounts—funded by the employer or through salary reduction—to pay expenses that fall into "statutory benefit" areas and are tax exempt (including health care reimbursement, child care reimbursement, etc.), with a further analytic break between those which allow salary reduction and those which don't;

(8) discretionary benefits that help the employee meet special needs and are tax exempt (including employer contributions to child care and legal plans); and

(9) discretionary benefits that have traditionally been called fringes and are intended to meet employer needs and are tax exempt (including employer provision of purchase discounts, job site cafeterias, special bonuses and awards, van pools, clubs, and parking).

Only after the question is answered regarding which of these benefits meet the criteria set above for justification of favorable tax treatment can the revenue level issue be approached. All available evidence, for example, indicates that the retirement, life, health and disability benefits now provided far exceed the value of the government revenue loss. In other words, policy change should more readily be based on the question of whether the programs are meeting objectives the Congress supports, not on the revenue issue per-se.

4. If certain compensation is not taxed, does Congress have to increase the tax rate on taxable compensation? Who benefits from that shifting of tax burdens?

If certain compensation is not taxed at all like tax exempt insurance costs or on a deferred basis like retirement and savings programs, then to raise a given amount of revenue tax rates would have to be higher if behavioral change is not involved. This is the greatest problem with tax expenditure estimates, they assume no change in behavior when a change in the tax law takes place. On the other hand, if taxing otherwise non-taxed compensation—in this case exempt benefits—leads to larger government programs, then tax rates might in fact be lower than they would otherwise be were all compensation taxed.

Were tax rates higher because of the exclusion or deferral of tax on benefits, however, a 1982 Treasury Department analysis undertaken for the Joint Economic Committee indicates that the burden would fall across the income spectrum on the same relative basis if benefits were valued as they are today. It is important to note, however, that the valuation of health insurance would likely change if taxed. The effect of this would fall most heavily on older workers at all income levels. This is because the true value of health insurance increases significantly as an individual ages, as evidenced by expenditure levels under the Medicare program.

5. How should we deal with tax-deferred compensation as opposed to tax-exempt compensation?

All forms of benefits should be evaluated against their ability to meet policy goals. Tax expenditure numbers for all programs should be considered in context of the warnings contained in the budget, however, and tax-deferrals should be carefully considered in terms of the amount of tax savings eventually repaid to the government: over 80 percent in nominal dollar terms and over 70 percent in real dollar terms. This means that long-term tax subsidies are much smaller than the current year budget number implies for tax-deferred benefits.

Estimates assume no other changes in the tax laws and estimates assume no change in taxpayer behavior if the law is changed—even if this is the only provision changed.

Economists refer to this as "partial equilibrium" analysis. This means that most behavioral change is assumed away so that rough estimates are possible. As a result, these estimates suffer as guides to policy. Therefore, they must be used with great care. Analysis cannot, for example, legitimately use the numbers to indicate that elimination of favorable employee benefit tax provisions would produce $X of additional revenue for the fiscal or $X for the use of such programs as Social Security, health insurance for the unemployed, or Medicare.

6. Which income groups and what kind of employees benefit from different forms fo employee benefits?

Benefits are now provided across the income distribution. In medium and large establishments, coverage for major employee benefits such as retirement, health, life and disability is nearly universal. Employee benefits are now a mainstay of the middle-income worker's economic security, building savings as well as providing hazard protection.

Employer pensions.—Of all full-time employees in medium and large establishments, 82 percent are covered by a pension plan. Small firms, for numerous economic reasons, do not sponsor plans as uniformly. In 1981 the President's Commission on Pension Policy concluded that this could only be changed by mandating plans or by offering tax credits. As firms grow, however, they do add retirement programs. Among employees in all establishments who were covered by pensions in 1983, nearly 28 million (or 59.0 percent) earned less than $20,000.

Pensions redistribute wealth to favor those at the lower end of the income scale who do not tend to save much out of current income. According to recent EBRI supported research, accumulated pension benefits constitute the major form of financial savings for more than half of all persons with pension coverage. More than 40 percent of the labor force reported no savings income in 1983. This group's average income was $9,651, just under half the average income of those reporting some asset income. Almost half of the group reporting little or no savings income were covered by an employer pension. Not all retirement benefits exhibit the same income distribution patterns, however. In particular, statutory provisions aimed at encouraging individual provision for retirement differ considerably. While 59 percent of pension participants earn less than $20,000, 46.5 percent of individual retirement account (IRA) holders and 34.8 percent of those participating in Section 401(k) plans fell into this income group. Section 401(k) plans in particular follow a different income distribution from both IRAs and employer-sponsored plans. More than half of Section 401(k) plan participants earn between $20,000 and $50,000, compared with under 50 percent for both IRAs and employer-sponsored plans.

Health insurance.—Of all full-time employees in medium and large establishments, virtually all are covered by health and by life insurance plans. Among all employees with employer-provided health coverage in 1982, 57.3 million (or 68.6 percent) earned less than $20,000, and 28.6 percent earned between $20,000 and $50,000. About 35 percent of all spending on health care that does not pass through government programs is now made through employer-sponsored plans. Fewer than 3 percent of pension and health insurance participants earn more than $50,000.

Increased Savings.—Pensions both increase and reallocate total savings. If pension contributions were received as cash income, total saving would decrease. The drop, moreover, would be relatively greater among lower- and moderate-income employees. While nonpension financial saving is concentrated among relatively high-income individuals, pensions are distributed broadly among income groups.

Pensions also change the distribution of saving among investment vehicles. Nonpension saving consists primarily of liquid saving deposits and investments in owner-occupied homes or other consumer durables. Pension funds, in contrast, are invested in securities that finance productive capacity and employment. Pension funds have grown to be the single largest supplier of investment funds to financial markets. At a time when unmet capital financing needs are emerging throughout the economy, the fact that pension funds provide long-term capital gives them an important role in economic policy.

Increased retirement income.—The availability of a pension often means the difference between subsistence and the ability to maintain pre-retirement living standards in retirement. Recent EBRI research projects that over the next forty years real retirement incomes will more than double. The average annual retirement income for those reaching age sixty-five in the 1980s is projected to be $13,376 per household in 1983 dollars. It is expected to increase to $26,802 for those retiring between 2110 and 2019. Average employer pension benefits will increase from $5,315 for those retiring in the 1980s to $12,417 for those retiring between 2010 and 2019. The proportion of new retiree households receiving pension income will grow from 37 percent in the 1980s to 71 percent by 2019.

Tax payments by retirees will reflect this income growth. Pension beneficiaries retiring in the 1980s will pay an average of $15,808 in taxes (1983 dollars) on their benefits over the course of their retirement. Pension beneficiaries retiring between 2010 and 2019, in contrast, will pay an average of $44,672 in taxes (1983 dollars) on pension benefits during their retirement.

Retirees not only receive larger retirement incomes as a result of employer pensions, but their benefits are more secure due to legally mandated advance funding. This security is all the more important as debates over the fiscal stability of the Social Security system continue. Social Security benefits and employer pension benefits complement each other. As pension benefits increase, Social Security benefits become a smaller share of retirement income. If public policy continues to encourage increased pension coverage and benefit levels, the pension system could reduce the pressure for ever-increasing Social Security benefits.

7. What effect would the various tax reform or tax simplification plans such as the flat tax or modified flat tax or the value added tax have on employee benefits?

The average taxpayer demanding tax reform because of a perception that the tax system is unfair does not see basic employee benefits as a tax abuse. Rather, both employers and employees see these benefits as part of the social contract that social contract that defines how individuals provide for themselves, their families, and their future. This social contract and related tax benefits includes the majority of the U.S. labor force. The distribution of benefit-related tax benefits among income groups reflects the distribution of coverage and participation. In 1981, employees earning between $15,000 and $50,000 received 71.8 percent of all health-related tax preferences, 64.5 percent of all pension-related tax preferences, and 67.5 percent of all insurance-related preferences. This group pays 51 percent of total federal taxes. By comparison, this income group received 64.2 percent of tax benefits related to homeownership. Employee benefits are less of a luxury than owning your own home.

One of the most important consequences of tax reform proposals that seek to restructure the tax system for the average taxpayer would be to change the tax treatment of employer contributions for employee benefits.

For workers with employee benefits there would be many implementation and transition issues in major tax reform. These could be formidable, and even predicting them involves some uncertainty about the reactions of employers, employees, insurers and other providers of benefits. This uncertainty arises from the fact that the availability of tax incentives for employee benefits has influenced how plans are provided and designed. For example, because employee benefits are purchased on a group basis, employers and employees can benefit from economies of scale. Therefore, a dollar spent on employee benefits by an employer buys more than would the same dollar spent by an individual. In the absence of tax incentives encouraging employer provision, the administrative structures that make group purchases cost-effective may never have been developed.

Alternative treatments for employee benefits that have been proposed include: Including benefit contributions in the employee's adjusted gross income; eliminating employer deductions for benefit contributions; capping the share of total compensation that can be provided in the form of tax-favored employee benefits; imposing an excise tax on the employer's benefit contributions; and imposing a value-added or national sales tax.

Including benefit contributions in the employee's adjusted gross income.—Most plans do not determine the costs of employee benefits on the basis of the characteristics of the individual for whom protection is being provided. These pricing structures are reasonable from employer's viewpoint given current tax treatment, since the total cost of insuring the employer's work force is not affected by the allocation of these costs among the members of the covered population. They are irrelevant to the employee who cares only about the total amount of insurance provided, and not about how the cost of this insurance is billed to the employer.

If employer contributions for benefits were taxed to the employee, the entire pricing and cost allocation structure of benefit plans could have to be revised to allocate contributions appropriately among individuals. While the average price of providing employee benefits to various employees may be uniform, the underlying cost of benefits differs widely according to the employee's age under all major benefits. Benefits for younger employees are less costly because these employees generally have lower health insurance claims, disability rates, and mortality rates. The adjustments that would be required would vary across benefits.

Pensions.—Actuarial methods used in defined-benefit pension plans do not generally allocate contributions or projected benefits to individuals, determining them instead for an employee cohort based on aggregate forecasts of that cohort's future demographic and economic experience. If defined-benefit pension costs were allocated among individuals, it would become clear that financing a given retirement benefit requires a lower contribution for a younger employee than for one closer to retirement age. The contribution for the younger employee can accrue interest over a longer period of time, while the same benefit increment for an older employee has to be financed primarily out of employer contributions.

Pension costs in a defined-benefit plan may therefore be ten times as high for an employee at age sixty as at age thirty. Attributing an average pension contribution to each employee would create serious inequities. Older employees would be undercredited, while younger employees would be overcredited. To the extent that older employees earn more and are taxed at a higher rate than younger employees, this inequity would be compounded.

Health insurance.—Employer contributions to finance health insurance are similarly based on the total cost of insuring a particular employee group. Underlying costs for health insurance can be twice as high at age sixty as they are at age thirty. Similarly, the underlying cost of providing health insurance for women of childbearing age is higher than the cost of insuring young, single men. In short, the average price of most employee benefits is much higher than the cost of providing benefits to some individuals and much lower for others.

If employer contributions for benefits were included in the tax base, they might be treated in the same way that the Internal Revenue Code now treats employer-paid life insurance premiums for coverage in excess of $50,000. These premiums are currently included in the tax base. The cost of life insurance varies according to the individual's age. For example, at age thirty, the cost of providing life insurance worth an individual's annual salary is 17 percent as large as it is at age forty-five, while at age sixty this cost is nearly four times as large.

To avoid the inequities that would arise if all individuals were taxed on an average cost of insurance, Treasury regulations prescribe the amount of premiums to be recognized as income for individuals on the basis of age (in five-year brackets) and coverage levels. The Treasury tables use blended actuarial assumptions for men and women based on the proportions of men and women in the group of employees with coverage over $50,000 in value.

To achieve an equitable distribution of tax liability, a schedule like that governing the tax treatment of life insurance would probably have to be developed for all employee benefits. Given the Supreme Court's decision in the *Arizona* v. *Norris* case, such tables would probably not be differentiated by sex. Such tables could, however, be differentiated by age, family status, or both. Family status could be used to predict health insurance claims plans that offer maternity or dependent's benefits.

Effects of taxing benefits.—The effects of taxing benefits would vary among benefits and would depend on whether or not individuals chose to continue their coverage. If pension accruals were taxed on a current basis, saving would almost certainly decline, and would decline disproportionately among those at lower income levels who do not tend to save out of current income.

To avoid the added tax liability, many low- and moderate-income individuals would choose to do without health and other types of insurance. Research conducted by the Employee Benefit Research Institute (EBRI) and others indicates that income determines whether or not people without employer-provided health coverage purchase such coverage themselves. If employers did not provide health coverage, most low-income workers would not purchase private health insurance. Since most people covered by an employer health plan are members of low- and middle-income families, employer-provided health benefits probably substantially raise rates of private health insurance coverage throughout the nonelderly population.

For those who chose to continue their insurance coverage, the impact of a tax on health insurance premiums would be regressive. While Employer contributions for health insurance are independent of employee earnings. As a result, the value of employer-provided coverage is a larger share of total compensation at lower income levels and the added tax payment of low-income workers would be a larger share of their income than at higher income levels. EBRI tabulations of data produced by the Congressional Budget Office (CBO) indicate that under the Administration's proposal to cap the amount of health insurance premiums that an employee can receive tax-free, those with the lowest incomes would pay more than six times as much tax as a percent of income as those with incomes above $50,000.

The flatter rate structure of some major tax reform proposals would exacerbate this regressively. Under current-law rates, the progressivity of the tax schedule offsets the effect on tax liability of the declining share of health insurance in compensation at higher income levels.

In short, whatever the criterion used for determining the cost of each employee's cost of benefits, if it targeted those individuals likely to have the highest incidence of claims, it would also target those most likely to need insurance. Since those most likely to become sick, disabled, or die would face the highest tax liability, taxing employer contributions for benefits would impose tax liability in inverse proportion to ability to pay.

Another potential effect of taxing employee benefits to the individual could be to increase the attractiveness of flexible compensation of cafeteria plans. Under flexible compensation plans, employees can elect various levels of coverage under the major types of employee benefit plans. An employee choosing a less-generous health insurance plan, for example, can "spend" the employer's cost savings on added life insurance, vacation days, or other benefits. All employees—except for those who chronically guessed wrong about their need for health insurance or other benefits—would segregate themselves into plans according to the expected value of their claims. While this is the fundamental principle behind flexible compensation plans, many employers sponsoring these plans now price the high-cost insurance options at less than the value of the claims expected under them to maintain a reasonable risk pool of participants under each option. If employees were being taxed on the value of employer contributions, however, such subsidies would probably have to stop, since they would mean that low-risk employees would be paying the tax bill for higher-risk persons. If all persons chose plans priced at the expected value of their claims, the risk-sharing inherent in group insurance plans would be eliminated.

Eliminating employer deductions for employee benefits.—Some of these distributional problems would not accompany major tax reform proposals that would include nonpension employee benefits in the tax base by eliminating employer tax deductions for them. The value-added tax could have this effect, depending on how it was designed, and some versions of the consumption tax would provide for this.

Faced with such a provision, employers who now offer benefits would probably cut them back and those who do not would probably not institute them. Some employers who offer benefits might eliminate them or continue to offer them with full employee payment.

Others might forego improving their benefit packages, while still others might institute or increase employee contributions, deductibles, or copayments where appropriate. Employers are already working to reduce their benefit costs; including benefits in the tax base would clearly accelerate this process but at a social cost.

The greatest impact of proposals to eliminate employer deductions for benefits would probably be on those employees who are not now covered. Most employees without benefit coverage tend to be in smaller firms and at lower income levels. As small and new firms grow and become profitable, they are more likely to incur the financial commitment involved in establishing employee benefit plans. Removing the tax deductions for employee benefits would probably make this commitment uneconomical.

Capping employee benefits as a share of total compensation.—Another alternative that has received some attention in tax policy debates, though not necessarily in the context of major tax reform, is establishing a limit on the share of total compensation that can be provided in the form of tax-favored employee benefits. Benefits provided in excess of this amount would be subject to payroll tax, income tax, or both.

Under alternative proposals, the cap could cover contributions for all benefits, or pensions, welfare benefits, and so-called "fringe" benefits could all be capped separately.

Such an approach could raise its own set of problems. For example, an employer with a mature, long-tenure work force could be put at a competitive disadvantage compared with an employer with a younger work force, even if the benefits in the two firms were identical. Furthermore, a cap could act as a target that firms with less-generous benefit plans would feel compelled to meet to maintain their competitive positions. The efforts of such employers to catch up could offset the effects on employers who benefits exceeded the cap. Such a system could also be difficult to implement for non-profit or public-sector employers, neither of which pay business profit taxes.

An excise tax on benefits.—Rather than capping benefits as a share of compensation, the Treasury in 1983 proposed imposition of an excise tax on all tax-favored benefits, whatever their level. This would avoid creating a target benefit level for employers to reach. An excise tax, however, would have the same effect on benefits as eliminating employer deductions for benefit contributions. Employers now offering benefits would cut them back, while those without benefits would probably not institute them. The only difference between the two options would be in the tax rates they would impose. If an excise tax carried lower rates than the corporate or business taxes the firm might be paying, then the incentives to eliminate benefits would not be as strong.

A value-added or national sales tax.—Instituting a value-added tax would not have the same effect as a tax levied specifically on benefits. Any tax levied at different stages of production would be neutral between wages and benefits as a form of compensation, assuming that both were subject to the tax, and thus would not change employer and employee preferences.

8. Should the tax law encourage employers to provide employee benefits; and if so, which benefits or services should be encouraged, and what type and level of tax incentive is appropriate?

The United States has always had a commitment to economic security for workers and retirees. Social Security with its income, health and disability components combines with workers compensation laws and unemployment compensation laws as an expression of public commitment. These social programs work with employer-sponsored programs to protect workers against significant health and economic risks. The government has established programs like Medicaid to take care of those without the employer protection, and it has provided tax incentives to encourage employer provision for the rest of the population.

The tax incentive approach allows programs to be designed to accommodate very different workforces, geographic conditions, and employee preferences, while still carrying out the federal government's social support agenda. Unless the nation decides to step back from its commitment to economic security, tax incentives will be essential to benefit provision. The testimony sets out nine categories that now receive favorable tax treatment that can be evaluated.

9. What conditions or restrictions are appropriate on tax incentives to encourage employers to provide employee benefits?

As a provider and encourager of benefits and economic security the government takes steps to assure that promised benefits are delivered, that all workers have access, and that expense is defined. This suggests funding requirements, nondiscrimination provisions, and percentage or dollar limits on employee benefits to control "tax subsidies or tax expenditures". It must be stressed, however, that the present system of benefit delivery would change if tax treatment changed.

10. Are the existing rules concerning employee benefits sufficient to ensure that all employees benefit fairly from the tax incentives?

The data presented in this testimony provides a clear yes to this question.

11. Are the existing tax incentives for benefits such as health care, life insurance, day care, educational assistance, and cafeteria plans effective in encouraging employers to provide these benefits to a broad cross section of employees at a lower total cost than if the Government provided the benefit directly, if employers provided the benefits on a taxable basis, or employees purchased these benefits on their own?

The first half of the question is easy to answer: benefits are being made available on a broad cross section basis. The second half of the question gets more complicated. And it is important that sound *benefits* be incorporated into this answer as well as cost. Note: employee benefits can accommodate different workers uniquely and can accommodate different geographic sections of the country; regressive taxation would result from the taxation of benefits where benefit cost is the same across the income stream (health, etc.); coverage gaps would be created if the employer chose to drop programs when taxed or also if employees chose to not purchase coverage. Finally, all available research indicates that the present system is the most cost effective and equitable method available to deliver the form and level of benefits now being provided.

12. How will tax laws that encourage employers to provide employee benefits affect compensation planning?

Research and experience show that economic security benefits will be provided more readily in the presence of tax incentives. The presence of these incentives, along with qualification requirements, assures provision across the income spectrum. It encourages total compensation planning.

13. Will tax incentives for employer-provided employee benefits affect potential employees' choice of employment?

The answer to this question is yes; the effect on behavior increases as workers grow older.

ENDNOTES

Numerous research projects sponsored by EBRI deal with these issues in greater detail. Examples are provided below.

For background on flexible benefits plans and their relevance to changing employee needs, see Dallas L. Salisbury, ed., "America in Transition: Implications for Employee Benefits" (Washington, D.C.: EBRI, 1982); Issue Brief "Flexible Compensation and Public Policy," no. 24; and Chapter XXII, "Flexible Compensation Plans" in "Fundamentals of Employee Benefit Programs" (Washington, D.C.: EBRI, 1983).

For further analysis of the tax treatment issues, see Sophie M. Korczyk, "Retirement Security and Tax Policy" (Washington, D.C.: EBRI, forthcoming). See also Issue Brief "Pension-Related Tax Benefits," no. 25 (December 1983) and Issue Brief "Employee Benefits and the 1985 Reagan Budget," no. 27 (February 1984).

For discussion of the interrelationship of programs see Sylvester J. Schieber, "Social Security: Perspectives on Preserving the System" (Washington, D.C.: EBRI, 1982).

Alternative tax systems would require detailed judgments about the treatment of various sources and uses of income. Both would also create some formidable implementation and transition problems. These problems and issues are treated in detail elsewhere. For a discussion of employer pensions in basic tax reform, see Sophie Korczyk, "Retirement Security and Tax Policy" (Washington, D.C.: EBRI, forthcoming) and "Basic Tax Reform: Implications for Employee Benefits," EBRI Issue Brief no. 28, March 1984. For a wide-ranging discussion of theoretical and practical issues in basic tax reform, see Dallas L. Salisbury, ed., "Why Tax Employee Benefits?" (Washington, D.C.: EBRI, 1984).

In smaller plans, the cost of providing health insurance for the marginal employee is based on the average costs of insuring the insured population of that community. In larger plans, the cost of insuring the marginal employee is based on the average cost of insuring the population represented by that employer's work force. While these two methods would be likely to yield different insurance costs for any given employee, under either method the cost of insuring that employee does not represent the cost of that employee's expected claims.

For a thorough discussion of health insurance see Deborah J. Chollet, "Employer-Provided Health Benefits: Coverage, Provisions, and Policy Issues" (Washington, D.C.: Employee Benefit Research Institute, 1984), p. 94. An EBRI simulation of private health insurance suggests that 56 to 87 percent of all covered workers with 1979 family income of less than $15,000 would not have purchased private health insurance, if an employer had not offered and contributed to their health insurance plan.

For a discussion of employer efforts to reduce health care cost, see "Controlling the Cost of Health Care: Recent Trends in Employee Health Plan Design," EBRI Issue Brief no. 23, October, 1983.

Chairman PICKLE. The Chair yields to Mr. Heftel.

Mr. HEFTEL. Do you really think we can assume that the percentage of income to the employee that is fringe benefit and nontaxable will not increase because if I am negotiating for employees, and I can negotiate a benefit that is nontaxable, I certainly will do so. So we should assume that there is a high risk of continuing increase in the amount of benefits which are tax exempt. And therefore would it be reasonable for us to assume that we have to come up with a cap?

Now I don't know where the cap is going to be placed, but since the smaller businesses that are trying to play catch-up certainly will find it more difficult if the larger firms, as we have heard you testify, keep moving up, would it not make better sense for both the equity to the Treasury and to the smaller firms, to at least place a cap on the percentage of total income that can be allocated to what we call tax free fringe benefits?

Mr. SALISBURY. Congressman Heftel, if I might, I think there is some evidence to be taken from the current unfortunate situation in the auto industry of bargaining that is going more difficultly than one might prefer and that one of the major issues there is the question of will employee benefit expenditures, percentage of wages and salaries, be allowed to continue to grow or not, in terms of the health provisions and the nature of those provisions.

If one looks at industry bargaining of the last two years at least increasingly, that is being renegotiated to limit that future growth. Whether that is a panacea or not and what that means for the future is the reason I am careful not to say that I think you will see no future growth.

But I would refer you quickly to chart 5, which I apoligize if I put words in the chairman's mouth or implied that. But I wouldn't want him either to put them in mine. What chart 5 shows is very, very, very significant variations on an industry-by-industry and employer-by-employer basis of the amount they are currently spending as a percentage of wages and salaries on benefits.

I do not tell this committee—I'm sure Mr. Alexander would differ with me. I am not telling the committee that you should not put a cap into effect. That is a political judgment and a policy judgment that is in your realm to make. What chart 5 and I are indicating is that if one were to decide they wanted a cap, determining where to put it it would be a very, very difficult thing to do. And this chart indicates if you did it at 20 percent, for lack of a better number, a significant number of millions of Americans would suddenly have income taxable, while millions of others would not.

That is a decision you need to face, but I am simply saying, the numbers from Social Security presented yesterday, because they are purely averages, can lead one to feel—I can put a cap here and no one will be affected until tomorrow. But nobody today will be affected. And chart 5 is simply tended to indicate to you that that is—it is not that simple.

You may still want to do it, but you will need to draw the line very carefully. It is my own judgment that the overall percentage of wage and salaries on an average basis will in fact continue to grow, even though for those employers today spending the most, that it will decrease or stay level, because of the types of things we are now seeing in the auto industry and elsewhere.

International competition is a key component of this. And in terms of competitiveness there is a tremendous pressure for those benefit expenditures among the largest, the people at 15 and 14.1 and the two and the 29 on this chart, to try and keep these numbers from going higher.

Mr. **Alexander**. Mr. Heftel, there is one other point. From the employer's standpoint a dollar compensation is deductible and a dollar put into employee health care is also deductible. From the employee's standpoint, the employee certainly would like to have a tax break, health care, to a point; only to the point necessary to give reasonable assurance to that employee and his or her family that they are going to be adequately covered.

Beyond that the employee would much rather have cash, even though it is subject to withholding tax, because the cash even after tax is a lot better than a fringe benefit, tax-favored, but unnecessary. So there is an economic cap in addition to the points Mr. Salisbury was making.

Mr. **Heftel**. Would you agree, then, that we should be looking at the maximums in determining whether or not at some point we need a cap?

Mr. **Alexander**. Mr. Heftel, I think that what this committee is doing today is highly constructive. I think the committee should look at this area. I am suggesting that I think that a cap, if set low, would create more problems than it cures. And, if set high, would produce little in the way of addition to our national revenues.

Mr. **Heftel** [presiding]. The chairman may not be with us for a while. I have a final report submitted to the Office of Advocacy, Mr. Swain, from James Bell and Associates.

Mr. **Swain**. Yes, sir.

Mr. **Heftel**. We will place that in the record.

Mr. **Swain**. Thank you.

Mr. **Heftel**. Are there any other comments from members of the panel?

Mr. **Romig**. Many, but in the interest of the committee's time we will thank you for your time.

Mr. **Heftel**. I want to thank you for your instructive testimony and your understanding of the problem we face. We will look forward to continuing the dialogue. Thank you.

Mr. **Salisbury**. Thank you, Mr. Chairman.

[The report referred to follows. Testimony continues on p. 417.]

COVERAGE, CHARACTERISTICS, ADMINISTRATION, AND COSTS OF PENSION AND HEALTH CARE BENEFITS IN SMALL BUSINESSES

FINAL REPORT

Submitted to

The Office of Advocacy
Small Business Administration

by

James Bell and Associates, Inc.
ICF Incorporated

March 1984

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EXECUTIVE SUMMARY

This study focuses on the extent of coverage, characteristics, administrative practices, and costs of pension and health care benefit plans in small businesses. This report also identifies some of the most burdensome aspects of health and pension regulations as reported by small businesses.

A. APPROACH

To achieve the study's objectives, the research effort was organized around five basic questions:

- First, to what extent is health and retirement plan coverage lower for small businesses?
- Second, what types of pension and health coverage do small businesses have?
- Third, to what extent do small firms spend more to provide health and pension benefits to their employees than large firms?
- Fourth, are the regulatory costs of employee benefit plans the reason that coverage rates are lower?
- Fifth, what are the key regulatory actions or policy changes that would be most important to reduce the costs to small businesses?

The research plan for answering these questions combined four types of analyses: (1) analyses of representative, national data; (2) analyses of non-representative, but more in-depth data on small businesses in certain regions of the U.S.; (3) interviews of small employers; and (4) interviews with benefit consultants who provide health and pension benefits to small employers. This approach produces both (1) results that are statistically generalizable to all employers (from the aggregate data analyses) and (2) an in-depth understanding of the characteristics and costs of small employers (gained from on-site case studies of individual employers and the other sources).

B. FINDINGS

Pension and Health Coverage

Chapter II indicates that pension and health plan coverage levels for workers in small businesses are substantially lower than the average for all firms. In 1977, 77 percent of employees in establishments with less than 100 employees were covered by health plans, as compared to 97 percent of workers in establishments with 100 or more workers. The differences are even larger for pension coverage: 47 percent of workers in establishments with less than 100 workers were covered in 1977, while 87 percent of workers in establishments with 100 or more workers were covered by pension plans. Of employees in establishments with less than 100 employees, 45 percent had both health and pension coverage and 21 percent had neither type of coverage. We also found that:

- The level of coverage for both health and pension benefits rises steadily with the size of establishment.
- If firms provide only one type of coverage, they are much more likely to offer health rather than pension plans. Firms typically adopt health plans before pension coverage for their workers is established.
- The manufacturing and finance industries have the highest percentage of health and pension coverage while the retail trade, construction, and services industries have the lowest. This is true for both small and large establishments.
- Workers in unionized establishments are substantially more likely to receive both health and pension benefits. Even the smallest unionized establishments have high levels of coverage: for example, approximately 90 percent of workers in unionized establishments with 1-24 workers have pension coverage.

- There is a strong correlation between wage levels in an establishment and health and pension coverage.
- Approximately 85 percent of the workers not covered by either health or pension plans in 1977 were in either: (1) establishments with average wage rates of less than $3 per hour in 1977; or (2) establishments with 25 or fewer employees.

The analyses of survey data provided by regional business organizations and interviews with small employers and pension consultants who serve small businesses showed that:

- The most important factor influencing the decision to establish pension benefits was firm profitability. Small businesses with pension coverage identified this as the prime reason for establishment of benefits, while small firms without pension benefits identified a lack of sustained profitability as a major reason for not forming benefit plans.
- Start-up costs, the need for expert assistance, the complexity and rate of change of regulations, and the lack of expressed interest on the part of employees discourages the formation of pension plans in small businesses.

Characteristics of Small Pension and Health Plans

Analyses of aggregate data show that:

- Small firms are more likely to have defined contribution plans than defined benefit plans. For example, 73 percent of the firms with fewer than 25 employees and 67 percent of the firms with 25-99 employees had only defined contribution plans--compared to just 7 percent of firms with 100 or more employees.
- Small firms are most likely to have profit sharing plans.
- Few firms with under 100 employees sponsor supplemental plans.
- The likelihood of integration of defined benefit plans increases as firm size increases--about half of the defined benefit plans in firms under 25 employees are integrated, while 72 percent of the defined benefit plans in firms over 100 employees are integrated.
- Firms with under 100 employees with defined benefit plans are less likely to have early retirement benefits.

Aggregate data analysis of the ICF Health Plan Data Base identified several characteristics of health plans sponsored by small businesses:

- Workers covered by small health plans are less likely to have family coverage than workers covered by large plans.
- Small firms tend to have less generous coverage than large firms--particularly in the areas of dental coverage and maternity benefits.
- Small firms are more likely to require employee contributions than large firms.
- Firms with less than 100 employees are most likely to have deductibles and co-insurance provisions.

In addition, regional survey data and interviews with small employers and pension consultants who serve small businesses showed that:

- Interviews with small employers and pension plan consultants suggested that profit sharing plans are selected, in part, because of their greater flexibility in terms of making contributions to the pension fund, as well as ease of start-up and on-going administration.
- The regional data bases indicated that the most frequently used combination of age/service requirements for pension plan participation among small firms is the ERISA maximum--25 years of age with one year of service.
- The regional data bases indicated that small firms are most likely to offer Blue Cross/Blue Shield health coverage. Health Maintenance Organizations (HMO) coverage is provided in only 10-15 percent of small firms. Only a very small percentage of small firms use self-insurance.
- Most firms--85 percent in one regional data base--had some form of deductible--usually $100 per year. About 80 percent of the firms within this same regional data base had co-insurance--under most plans the insurance paid 80 percent of medical expenses and the employee paid the remaining 20 percent.

Administration and Costs of Small Pension and Health Plans

Analyses of aggregate data showed that per capita pension costs are substantially higher for small establishments than large establishments. For example, per capita costs decline from $1,080 for establishments with 1-10 workers to $574 for establishments with 500-999 workers.

A major reason for this difference is the cost of pension plan administration. Administrative costs, on a per worker basis, are highest for small firms and decrease as firm size increases. Other findings from the analysis of national, aggregate data on retirement plans include:

- Costs differences in pension plans are due to several factors, including: (1) administrative costs, (2) benefit generosity, (3) wage levels.
- On the basis of discussions with plan administrators and actuaries, minimum on-going administrative costs are typically $400 for a defined contribution plan and $600 for a defined benefit plan.
- Per capita administrative costs for defined benefit plans exceed those for defined contribution plans regardless of firm size.

Analyses of aggregate data on health benefits indicated that total per capita costs for individual health care coverage are highest for firms under 50 employees--$41 in monthly premiums. However, per capita cost for family coverage are highest for firms with 100 or more employees-$101 in monthly premiums--and lowest for firms with 50-99 employees. Also the aggregate analyses demonstrated that large employers (over 100 employees) pay the highest percentage of health care premiums--95 percent of premiums for individual coverage and 91 percent for family coverage. Small firms, in the 50-99 employee range, paid the lowest share of premiums--68 percent for individual coverage and 51 percent for family coverage. Finally, across all firm size groupings, employers pay a higher percentage of premiums for individual coverage than family coverages.

The analyses of regional data and interviews with small employers and pension consultants showed that:

- One regional data base suggested that about one-half of the small firms administer their pension plans themselves, about one-third use outside plan administrations and about one-seventh rely on insurance companies.
- In setting up pension plans, most small employers utilize expert pension advisors--including actuaries, attorneys, etc.--at considerable costs. Depending upon the size of the firm and the type of plan selected, start-up costs are an estimated $2,000-5,000 for small plans.
- According to pension consultants and small employers, on-going administrative costs for small firms (under 100) are an estimated $500-1,500 per year--depending upon the type of plan and number of participants.
- Small employers and pension consultants indicated several areas of regulation and reporting requirement that are burdensome--including parts of the Form 5500, "controlled group requirements", "percentage coverage requirements", some regulations under Multiemployer Pension Plan Amendment Act (MPPAA) and "merger and spinoff rules".
- Many small employers observed that it was not so much the regulations that were a burden, but rather the constant changes in laws and regulations--which often imposed substantial costs on the firms when they made plan amendments.

C. IMPLICATIONS AND CONCLUSIONS

This study confirmed that small businesses are significantly less likely to offer pension and heath care benefits to their employees. If pension and health care coverage of workers in the United States is to expand in upcoming years, the impetus for expansion is most likely to come from small firms because nearly all firms with over 500 employees currently offer both health and pension benefits to their employees.

Pension Benefits

On the basis of our analyses of aggregate data and interviews with small employers and actuaries, several alternatives have been identified which would facilitate and encourage formation of plans among small employers, including:

1. reduction in the costs of establishing plans;
2. decrease in the complexity of establishing and maintaining plans;
3. provision of monetary incentives--e.g., in the form of tax credits--to cover the costs of plan formation; and
4. reduction in the burden and complexity of complying with current and future regulations governing pensions.

A major finding of this study is that costs of plan start-up for small firms are substantial--typically, in the $2,000-5,000 range. A reduction in start-up costs or a spreading of these costs over several years would encourage many small firms to set up plans. One avenue for reducing start-up costs would be the development of more flexible IRS prototype pension plan documents with variable provisions which small firms could adopt without expensive, expert consultation. Other possible methods for reducing start-up costs for small businesses would be to offer tax credits to cover set-up costs or to enable small firms to spread costs over the first 3 to 5 years of the plan's existence.

Beside the costs of initially setting up plans, our analyses show considerable concern among small employers over frequent changes in regulations governing pensions. What many employers found excessively burdensome and problematic was constantly changing and increasingly complex pension rules and regulations. These changes were not only costly--some businesses said they had to amend their plans nearly every year at substantial costs--but also created a condition of excessive uncertainty about the future. Some smaller owner-operators were reluctant to set up plans because they were unsure about the impact of future regulatory developments. One solution to this problem might be to give already established plans a longer period to come into compliance.

Health Care Benefits

This study shows that the central issue with respect to health benefits in small firms is the rising costs of these benefits. In recent years, with health care premiums rising rapidly, small firms have begun to ask serious questions about whether they can afford to fully cover employees and about the types of coverage they can afford to offer. Increasingly, firms are instituting the following changes to their plans:

- they are moving away from high option coverage to standard coverage;
- employees are being asked to share in the costs of coverage by making monthly contributions to the cost of coverage;
- employers are adjusting plans to include higher deductibles; and
- firms are instituting co-insurance features.

In general, employers have attempted to shift costs of health coverage to employees-both to make them aware of cost increases and to help in meeting costs. Whether these measures will prove effective in curbing cost increases is still uncertain.

I. INTRODUCTION

A. BACKGROUND

In its final report, the President's Commission on Pension Policy recommended that all employers be required to establish a retirement plan for their employees. They made this recommendation because they thought that, under current policies, pension coverage was unlikely to increase significantly. The major reason coverage was unlikely to increase was "the lack of pension offerings in small businesses".

The Commission's report discussed several possible reasons for the lack of retirement plans in small business. The foremost reason cited by experts is cost. Costs for fringe benefits are higher in small businesses for a number of reasons. First, the after-tax cost of offering benefits is higher because small businesses typically have lower net income than large businesses. As a consequence of the graduated corporate tax rate, the tax advantage of offering retirement and health benefits is less for small businesses than for large businesses.

A second factor which makes the costs of retirement and health plans greater for small businesses than large businesses is the cost of their administration. For example, establishing a retirement plan involves actuarial, accounting, insurance, and investment services. The cost of these services is usually not a function of the number of participants, but rather a function of the time involved in drafting the plan document, auditing the plan's assets, selecting securities, etc. As a result, the costs are relatively higher for small businesses than for large businesses.

The relatively higher administrative costs to small businesses have been analyzed empirically in several studies. In a recent analysis of pension plan costs, Emily Andrews and Olivia Mitchell found that administrative expenses per participant in small pension plans were seven times larger than for large plans.[1] A 1980 survey conducted by the Profit Sharing Council of America examined the investment costs of small profit sharing plans. It found that for plans with less than $200,000 in assets, the average investment cost per $100 invested was $6.48. For plans with more than $10,000,000, however, the cost was only $1.32.[2]

Many of these cost differences stem not only from the higher per-unit costs of administering a small pension or health plan, but also from the additional burden imposed by government regulations. Exhibit I-1, for example, shows some of the specific actions which were required by the Employee Retirement Income Security Act (ERISA) for pension. The direct and indirect incremental costs of the regulatory impacts of ERISA have been studied by a number of groups. First, Arthur Andersen & Company conducted a study in 1978 for the Business Round Table which found that the incremental administrative costs of ERISA for the smallest employers studied were nearly seven times as great as the average incremental cost of the ten largest employers studied.[3]

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[1] Olivia S. Mitchell and Emily S. Andrews, "Scale Economies in Private Multi-Employer Pension Systems", Industrial and Labor Relations Review, Vol. 34, No. 4, July 1981.

[2] Cited in Herbert Liebenson, National Small Business Association, "Retirement Policy and Small Business", 1980.

[3] Arthur Andersen & Company, Cost of Government Regulation Study, Executive Summary, 1978

EXHIBIT I-1

SPECIFIC FUNCTIONS REQUIRED BY ERISA

Administrative Requirements

Plan amendments to satisfy the provisions of ERISA

Detailed recordkeeping requirements to comply with rules relating to:
- Record Retention
- Eligibility
- Breaks in Service
- Vesting
- Rehiring
- Marital Status

Procedures to allow:
- Statement to separated employees
- Written explanation of joint and survivor annuity option
- Explanation of denial of claim
- Availability of plan documents

For defined benefit plans:
- Maintenance of a "funding standard account:

Insurace Requirements

Fiduciary liability insurance (optional)
Bonding expense
Plan termination insurance premiums (defined benefit plans)

Reporting and Disclosure Requirements

Department of Labor

Plan description (Form EBS-1)
Summary Plan Description
Changes in plan description (Amended EBS-1)
Updated Summary Plan Description
Annual Report (Form 5500)
Terminal Reports if applicable

Internal Revenue Service

Annual Registration Statement (Schedule SSA of Form 5500)
Notification of Change in Status
Annual Report (Form 5500)
Defined Benefit Plans Only:
- Actuarial Information (Form 5500 Schedule B)
- Actuarial Valuation (first year and every third year thereafter)

Pension Benefit Guaranty Corporation
(Defined Benefit Plans Only)

Premium payment declaration and annual report (Form PBGC-1)
Notice of plan termination
Reportable event notice

Disclosure to Participants

Summary plan description
Updated summary plan description (every five years)
Summary of changes in the plan description
Summary annual report
Written notice of reason for denial of abenefit claim
Statement of benefits (upon request)
Statement of terminated vested participant's benefits

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[1] Modified from U.S. Department of Labor, Assessment of the Impact of ERISA on the Administrative Costs of Small Retirement Plans, prepared by Price Waterhouse & Co., Office of Government Services, (Washington, D.C., 1977).

A second study conducted for the Department of Labor in 1977 found that as a result of ERISA, the average administrative costs for small plans (less than 100 participants) increased by 72 percent.[1]

As we found in this study, added costs are only part of the story because small businessmen in many instances also do not have the expertise or the time necessary to complete all of the government forms accurately, whatever the cost to do so.[2]

ICF Incorporated completed a study in 1980 for the Department of Labor which showed that not only were the added administrative costs of ERISA for small firms greater, but the added costs of complying with ERISA's participation, vesting, joint and survivor, and benefit accrual provisions were also higher for small plans.[3] The higher direct costs of complying with ERISA's provisions stemmed both from the fact that small firms had newer, less generous plans and because their workforces were, in general, younger than those of larger firms.

The impact of these regulatory costs on the decision not to offer pension and health plans by small businesses has also been studied. A 1979 Department of Labor study prepared by Abt Associates evaluated the effects of ERISA on the decision to form a new pension plan. The study included 52 firms that had seriously considered but decided against plan establishment. Seventeen of these 52 firms indicated that ERISA was significant in their decision against plan establishment.[1] A Battelle study examined the effect of regulatory costs on the decision to offer a health plan. Exhibit I-2 shows that although regulatory costs were the single most important factor for not offering a group plan for only two percent of firms, over 25 percent of firms felt they were an important reason.

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[1] U.S. Department of Labor, Assessment of the Impact of ERISA on the Administrative Costs of Small Retirement Plans, prepared by Price Waterhouse & Co., Office of Government Services, (Washington, D.C., 1977).

[2] Op. cit. Liebenson.

[3] ICF Incorporated, An Analysis of Pension Plan Costs, 1972-76, prepared for the Department of Labor (Washington, D.C., 1980).

In spite of much of this research, there remain a number of unanswered questions about the coverage and types of benefits offered in the health and pension plans of small businesses. It is important that these unanswered questions be addressed soon. The Congress has been considering major reforms to the participation and vesting provisions of ERISA as well as changes in the tax treatment of employer deductions for health care coverage and a variety of proposals to increase health care competition. In the area of pension policy, for example, one proposal would set up a separate pension plan termination insurance program for small employers. However, Congress has been reluctant to establish this type of program, in part, because not enough is known about the characteristics of small plans relative to large plans. Also of interest is which specific parts of ERISA's regulations impose the greatest burden on small businesses and provide the greatest barriers to the adoption of new health and retirement plans.

In the area of health care policy, unanswered questions exist about the impact of various health care competition proposals on small businesses. For example, it may be an unnecessary burden on small business to require them to offer expensive HMO coverage options if only a small number of individuals are likely to join these plans. It may also be unrealistic to expect to realize

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[1] Abt Associates, Inc., Evaluation Study of the Formation of New Pension Plans. Volume I (Cambridge, Massachusetts, April, 1979), p. 3.

EXHIBIT I-2

REASONS FOR NOT PROVIDING A GROUP HEALTH PLAN

Factor	Very Important	Somewhat Important	Not Too Important	Refused or Don't Know	Total	Single Most Important Factor
Government reporting requirements	11%	16%	65%	8%	100%	2%
General administration paper work	17%	18%	55%	10%	100%	4%
Costs of benefit or insurance	50%	17%	23%	10%	100%	29%
Size of your company	59%	14%	17%	10%	100%	35%
Having workers already covered under union or other plan	20%	12%	57%	11%	100%	10%
Tax considerations	16%	18%	53%	13%	100%	3%

SOURCE: Battelle Human Affairs Research Centers, "Study to Develop Methods of Encouraging the Growth and Maintenance of Employee Benefit Plans Among Firms with No Such Plans", June 1980.

significant cost savings from requiring small businesses to offer two health options if most small businesses currently have "low option" plans.[1]

B. PURPOSE OF THIS STUDY

The central objective of the study is to assess the cost to small employers of providing employee benefits relative to the cost to large employers. This study focuses on the level of coverage and the types of benefits offered by the pension and health benefit plans of small businesses, as well as administrative practices and costs. In addition, we identify the most burdensome aspects of health and pension regulations to small business.

In order to achieve the study's objectives, we organized our research efforts around five basic questions:

- First, to what extent is health and retirement plan coverage lower for small businesses?
- Second, what types of pension and health coverage do small businesses have?
- Third, to what extent do small firms spend more to provide health and pension benefits to their employees than large firms?
- Fourth, are the regulatory costs of employee benefit plans the reason that coverage rates are lower?
- Fifth, what are the key regulatory actions or policy changes that would be most important to reduce the costs to small businesses?

C. METHODOLOGY

In developing the research plan, we determined that the research questions could be answered most efficiently and effectively by combining the results of four types of analyses: (1) analyses of representative, national data; (2)

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[1] See a discussion of this issue in ICF Incorporated, "Analysis of the Short-Term Impacts of Selected Pro-Competition Measures on Private, Employment-Related Health Plans", prepared for the Health Industry Manufacturer's Association, 1981.

analyses of non-representative, but more in-depth data on small businesses in certain regions of the U.S.; (3) interviews of small employers; and (4) interviews with benefit consultants who provide health and pension benefits to small employers. This approach produces both (1) results that are statistically generalizable to all employers (from the aggregate data analyses) and (2) an in-depth understanding of the characteristics and costs of small employers (gained from on-site case studies of individual employers and the other sources).[1]

The five major tasks of the study reflected the key research questions:

- Task 1 -- Needs Specification
- Task 2 -- Analyses of Coverage
- Task 3 -- Characteristics of Retirement and Health Plans
- Task 4 -- Administrative Practices and Costs
- Task 5 -- Analysis of Factors Affecting Costs and Coverage.

Needs Specification

It is often difficult to target data collection and analysis in the most germane and potentially useful areas for policy makers. Consequently, in the initial task of this project, we identified the information needs and research products needed by key decision-makers in the policy process. This technique, known as needs specification, helps to overcome this difficulty by (1) identifying key individuals in the policy process and (2) interviewing them to gain vital information on issues and gaps in existing data and knowledge.

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[1] Another possible approach could have been to conduct a large survey of employers. We did not use this approach because of the large burden it would have imposed on employers relative to its added value. We note that the research plan did not involve OMB forms clearance because no more than nine employers were asked the same set of questions in the interview process.

With approval from the project officer, we interviewed nine individuals from the government, congressional staffs, independent experts and representatives of small business outside government. We asked them to review the study questions, discuss priorities among questions, suggest additional high priority questions and discuss potential uses of information resulting from the study.

Interviews conducted with the government officials, congressional staff members, independent experts, and representatives of small business stressed the importance of direct contacts and detailed interviews of small businesses to develop what one respondent referred to as the "nuts and bolts" problems of pension and health care plan administration and costs. Interviewees indicated particular interest in evidence that would highlight the actual characteristics of benefit plans, administrative practices and related costs, and particularly, effects of regulation and problems that small firms face in setting up and maintaining benefit plans. These interviewees also suggested that greater emphasis be placed on examination of pension issues (versus health benefits issues) because of lower rates of pension coverage among small firms, greater complexity of regulations governing pensions, and the likelihood of legislation affecting pension regulation in upcoming Congressional sessions. Hence, in addition to examining aggregate national data bases, we placed considerable emphasis on detailed discussions and case studies of the retirement plans of small business firms. Appendix E describes these interviews in detail.

Analysis of Coverage

In this second task, we analyzed the percentage of employers who sponsor health and retirement plans. This task built upon previous research conducted by ICF and others on the levels of health and pension plan coverage by employers of different sizes. In contrast to other studies which have analyzed only pension or health coverage, however, JBA and ICF analyzed the offering by employers of: (1) health benefits only (no pension benefits), (2) pension benefits only (no health benefits), (3) neither health nor pension benefits; and (4) both health and pension benefits.

To conduct these analyses, we used the Expenditures for Employee Compensation (EEC) Survey conducted by the Bureau of Labor Statistics in 1977. The EEC data included employee benefit information for a representative sample of over 6,000 employers during 1977. The data in the EEC survey include information on employer expenditures for pensions, health coverage, and other employee benefits.

In this task, we also conducted in-person and telephone interviews with 15 small employers--eight firms with pension and health plans and seven firms with health plans but without pension plans. These interviews focused on the reasons small employers did or did not have pension and/or health coverage. The selection of employers for these interviews was guided by two small business organizations: the Greater Cleveland Growth Association and the Smaller Manufacturer's Council of Pittsburgh.

These interviews were intended to enrich and supplement the aggregate data analyses undertaken during this task. For example, when the analysis of existing data sources indicated that coverage by pension and health care benefit plans was related to firm size, interviews were then aimed at identifying factors that influenced the decision to offer benefits. In addition, interviews with small businesses provided preliminary indications of key factors--such as type of business, government regulation, administrative costs and burdens, and firm profitability--which appeared to influence directly decisions concerning the offering of employee benefits.

We used two other sources of primary data during this task: (1) the Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits, and (2) the Smaller Manufacturer's Council of Pittsburgh's (SMC) 1982 Wage and Fringe Benefit Survey. The SBANE Survey was conducted during 1982 with 176 small businesses in the Boston area. The SMC Survey was conducted during 1982 with 242 small firms in the Greater Pittsburgh area. It included detailed questions on wage rates, health care plans, retirement plans, and a host of other fringe benefits. While neither of these surveys used random sampling procedures, they provide rich, current data to supplement and extend our aggregate data analyses. A more detailed discussion of these two data bases and copies of the survey instruments appear in Appendix D.

Retirement and Health Plan Characteristics

In the third task, we analyzed the types of benefits offered by small employers with health and/or pension plans. Using two data sources developed by ICF, this task compared the different levels and types of benefits offered by both large and small employers. Several other sources of data were also used, including: telephone interviews with small firms, case studies of small firms and pension consultants, and the SMC and SBANE data bases.

We used two aggregate data sources to analyze the characteristics of the benefit plans in this task. For health plan benefits, we used the ICF Health Plan Data Base which is a representative sample of over 2,100 employer sponsored health plans. It is composed of data provided in both the 1977/1978 Battelle Survey of Employers and the 1977 BLS Survey of Health Plans. The Battelle data on employers with less than 26 employees were included in the

ICF data file because they are the most recent publicly available data on health coverage for small employers. However, because the Battelle data have an unacceptably low rate of response among larger employers, ICF obtained data on larger employer-sponsored health plans from the 1977 Bureau of Labor Statistics Health Plan Survey. This BLS survey provides data on a representative group of plans with 25 or more participants. These merged data from the Battelle and BLS surveys, called the ICF Health Plan Data Base, contain the most extensive and recent data publicly available which is representative of all employer health plans.[1]

Data on the characteristics of retirement plans came from the ICF Retirement Plan Provisions Data Base. This representative plan sponsor data base is stratified by industry, firm size, and multi/single employer status. It provides plan provision data for both the primary and supplemental defined benefit and defined contribution plans offered by public and private sector sponsors. For each of these sponsors, ICF obtained Summary Plan Description (SPD) data on their retirement plans.[2] The data base includes all relevant plan provisions for participation, vesting, hours crediting, retirement, death, disability, joint and survivors benefits and social security integration.

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[1] It has been used in other published studies. See ICF Incorporated, "Analysis of the Short-Term Impacts of Selected Pro-Competition Measures on Private, Employment-Related Health Plans", prepared for the Health Industry Manufacturer's Association, 1981.

[2] The sample was originally developed in 1980 for the President's Commission on Pension Policy. It was updated in 1982 under contract with the Employee Benefit Research Institute.

We also conducted telephone interviews, case studies and analyzed the SBANE and SMC Surveys. Eight small firms were asked a series of questions about the characteristics of their pension plan and fifteen small firms were asked questions about the characteristics of their health plans. These discussions were aimed at filling gaps in currently existing data and extending the depth of analyses concerning the provisions and types of employee benefits offered by small employers. Project staff also analyzed questions pertaining to health and retirement benefits within the SBANE and SMC data bases.

Pension and Health Plan Administrative Practices and Costs

In this task, we examined the differences in the level of expenditures for pension and health benefit plans between small and large firms using the 1977 version of the Bureau of Labor Statistics Survey of Employer Expenditures for Employee Compensation (EEC). We analyzed the EEC data to calculate the frequencies of health and pension plan expenditures in various industries, size categories, and wage classes.

We used several other sources of data to analyze the administrative practices and costs of small pension and health plans. These sources included telephone interviews with small employers, case studies of small firms and pension consultants, and the SBANE data base. The SBANE data base provided data on administrative practices and some data on the percentage of the firms' payroll spent on pension benefits and health care plans.

We also conducted case studies with three small employers in the Cleveland area. These small firms--a steel wire manufacturer, a rigging and moving firm, and a real estate developer--had both pension and health care plans. These on-site case studies examined reasons for coverage and selection of particular plans, characteristics of plans, administrative practices, costs and factors affecting costs, and impacts of government regulations. Appendix A provides a detailed summary of each case study.

We also conducted two case studies of independent, actuarial pension plan consultants during this task. These interviews were aimed particularly at the analysis of administrative practices, costs, factors affecting costs, and effects of regulations. Appendix B provides a detailed summary of each case study.

Factors Affecting Costs and Coverage

The final task of the study focused directly on the factors which affected costs of employer benefits plans as well as the extent of coverage. An important part of this task was identifying specific regulations that increase the costs of benefits for small businesses.

During this task, we examined evidence from the telephone discussions with fifteen small employers, the three on-site case studies, and the two interviews with pension consultants. This task was instrumental in verifying and extending project findings concerning regulatory actions and identifying policy changes that would be most important in reducing the cost of health and pension benefits for small businesses.

D. ORGANIZATION OF THE REPORT

This report is aimed at providing SBA with data analysis and information to assist in the formation of policy positions. The report has been divided into three major chapters. In Chapter II, we examine the extent of pension and health plan coverage in small business firms. In Chapter III, we present data on the characteristics of pension and health plan benefits in small business firms. Chapter IV then discusses our analysis of the administration and factors affecting the costs of pension and health benefit plans in small firms.

Within each of these chapters, we have provided a brief summary of findings, followed by three levels of analysis to support these findings:

- Findings from National Aggregate Data Analysis
- Findings from Regional Surveys of Small Business Firms
- Findings from On-Site Case Studies and Telephone Discussions.

A final chapter--Implications and Conclusions--examines the implications of this study for the current policy debate concerning employer pension and health care benefits. Several appendices, following the final chapter, provide more detailed description of the analyses.

II. PENSION AND HEALTH COVERAGE

A. OVERVIEW

This section presents information about differences in health and pension coverage among business establishments of varying sizes and the key factors responsible for these differences.

In analyses of national aggregate data, we found that in 1977, 65.1 percent of all workers were covered by both health and pension plans, 21.8 percent by health benefit plans only, 1.5 percent by pension benefit plans only, and 11.6 percent by neither type of plan.

Our analyses indicated that, as expected, coverage levels for workers in small businesses are substantially lower than the average for all firms. We found that in 1977, only 77 percent of employees in establishments with less than 100 employees were covered by health plans, as compared to 97 percent of workers in establishments with 100 or more workers. The differences are even larger for pension coverage: only 47 percent of workers in small establishments (less than 100 workers) were covered in 1977, while 87 percent of workers in establishments with 100 or more workers were covered by pension plans. In addition, we found that only 45 percent of employees in establishments with less than 100 employees had both health and pension coverage and that 21 percent had neither type of coverage. We also found that in 1977:

- The level of coverage for both health and pension benefits rises steadily with the size of establishment. For establishments with fewer than 10 employees, only 30.9 percent of workers are covered by both health and pension benefits, while for establishments with more than 2,500 employees, 95.3 percent of workers are covered by both types of plans.

- If firms provide only one type of coverage, they are much more likely to offer health rather than pension plans. Our analyses also indicate that firms typically adopt health plans before they establish pension coverage for their workers.

- On an industry level, the manufacturing and finance industries have the highest percentage of health and pension coverage while the retail trade, construction, and services industries have the lowest. This is true for both small and large establishments.

- 91.4 percent of workers in unionized establishments receive both health and pension benefits compared to 55.6 percent of workers in non-unionized establishments. Even the smallest unionized establishments have high levels of coverage: for example, approximately 90 percent of workers in unionized establishments with 1-24 workers have pension coverage.

- There is a strong correlation between wage levels and health and pension coverage. For employees in establishments with an average hourly wage of less than $3 per hour in 1977, 49 percent received both health and pension benefits while 84 percent of employees in establishments in which the average hourly wage rate was $6 or more in 1977 did so.

- Approximately 85 percent of the workers not covered by either health or pension plans in 1977 were in either: (1) establishments with average wage rates of less than $3 per hour in 1977; or (2) establishments with 25 or fewer employees.

From our analyses of regional data and interviews with small employers and pension consultants who serve small businesses we found that:

- The two regional data bases confirm that pension benefit coverage rises steadily with the size of establishments. Overall, SBANE and SMC data show that 55-60 percent of the firms with under 500 employees had pension coverage.

- The most important factor influencing the decision to establish pension benefits was firm profitability. Small businesses with pension coverage identified this as the prime reason for establishment of benefits, while small firms without pension benefits identified a lack of sustained profitability as a major reason for not forming benefit plans.

- Other important reasons given in these interviews for establishing pension plans included: a desire to offer competitive levels of compensation, union negotiations, a desire to share profits with employees, and a desire to provide for employees' retirement.

- Start-up costs, the need for expert assistance, complexity, frequently changing regulations, and lack of expressed interest on the part of employees discouraged formation of plans in small businesses.
- Health benefits were regarded, in most cases, as an expected benefit by both employers and employees--one that was generally provided by firms to employees if they were to remain competitive in the labor market.

B. FINDINGS FROM NATIONAL AGGREGATE DATA ANALYSIS

We used data from the 1977 Expenditures for Employee Compensation (EEC) Survey, conducted by the Bureau of Labor Statistics, to analyze differences in health and pension coverage among business establishments of varying sizes.[1] The EEC data include information on employee benefit plan coverage from a representative sample of over 6,000 private sector, non-agricultural establishments in 1977.

Using the EEC data for 1977, we examined four categories of coverage: (1) coverage for health benefits only (no pension plan), (2) coverage for pension benefits only (no health plan), (3) coverage for both health and pension benefits, and (4) neither health nor pension plan coverage. Pension covered workers were defined as those workers whose employer made payments to a pension plan for some or all of his employees. Similarly, workers covered by a health plan were defined as those workers whose employer made contributions for a health plan for some or all of his employees.

Exhibit II-1 shows that coverage for both health and pension benefits increases with establishment size. This exhibit shows that in 1977:

- Almost 87 percent of workers are in establishments with health plans, while only 67 percent are in establishments covered by pension plans.

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[1] BLS has not conducted the EEC survey since 1977.

EXHIBIT II-1

HEALTH AND PENSION COVERAGE, BY ESTABLISHMENT SIZE, 1977

Establishment Size	Health Coverage	Pension Coverage
1-9	55.6%	33.6%
10-25	79.2	41.4
26-49	84.1	52.3
50-99	88.7	59.7
100-499	95.8	78.4
500-999	96.0	90.8
1,000-2,499	98.9	95.2
2,500+	99.5	95.7
Total	86.9%	66.6%

SOURCE: 1977 Expenditures for Employee Compensation (EEC) Survey, Bureau of Labor Statistics.

- Only 77 percent of employees in establishments with less than 100 employees were covered by health plans, while 97 percent of workers in large establishments (i.e., with more than 100 employees) were covered by health plans. A sharp distinction in coverage for employer health plans is found between establishments with less than 10 employees and establishments with 10 or more employees: about one-half of employees in establishments with fewer than 10 employees have health coverage, while four-fifths of employees in establishments larger than this size are covered.

- Only 47 percent of workers in establishments with less than 100 workers were covered by pension plans in 1977, while 87 percent of workers in large establishments were covered by pension plans.

- The percentage of establishments in a size group with health benefits always exceeds the percentage of establishments with pension coverage.

- While almost 90 percent of workers in establishments with 50 or more employees have health coverage, the 90 percent coverage level for pensions is not reached until establishments have 500 or more participants.

Exhibit II-2 shows that only about 31 percent of establishments with less than 10 employees had both health and pension coverage in 1977 and that about 42 percent of all establishments with fewer than 10 employees had neither a health nor pension plan in 1977. This exhibit also shows the strong correlation between health and pension coverage and establishment size. The percentage of establishments with coverage for neither benefit drops quickly: while over 40 percent of establishments with fewer than 10 employees had neither health nor pension coverage in 1977, only 10 percent of establishments with 50-99 employees had coverage for neither benefit.

Exhibit II-2 also shows that if an establishment has only one type of benefit, it is most likely to have health coverage. For example, almost 25 percent of establishments with fewer than 10 employees have health coverage only, while only three percent of establishments of this size have only pension benefits. This also indicates that establishments are much more likely to adopt health benefits before adopting pension coverage.

EXHIBIT II-2

HEALTH AND PENSION COVERAGE BY ESTABLISHMENT SIZE, 1977

Establishment Size	Health Only	Pension Only	Both Health and Pension	Neither
1-9	24.7%	2.7%	30.9%	41.6%
10-25	40.2	2.3	39.1	18.4
26-49	34.5	2.6	49.6	13.3
50-99	30.0	1.0	58.7	10.3
100-499	18.5	1.1	77.4	3.1
500-999	6.7	1.4	89.3	2.5
1,000-2,499	4.1	0.3	94.9	0.8
2,500+	4.2	0.4	95.3	0.1
Total	21.8%	1.5%	65.1%	11.6%

SOURCE: 1977 Expenditures for Employee Compensation (EEC) Survey, Bureau of Labor Statistics.

Exhibit II-2 shows that, on average, establishments with 1-9 employees are likely to have either no pension or health coverage (42 percent) or just health benefits (25 percent). Somewhat larger establishments (10-25 workers) are most likely to have health benefits, but not pension benefits. Establishments with 25-49 workers are likely to have at least health benefits (84 percent) or both health and pension benefits (50 percent). Almost all establishments with more than 50 workers have health plans, and a majority of these establishments have both health and pension coverage. When an establishment has 500 or more employees, it is extremely likely that it will have both health and pension benefits.

Health and pension coverage also vary significantly by industry. Exhibit II-3 shows that the highest degree of both health and pension coverage is provided by the manufacturing (durable goods) and finance industries, while the trade, services, and construction industries have the lowest coverage levels.

Many of these industry differences are found because the low coverage industries have a higher proportion of small firms--many of which are new, nonunionized, and have low wage level workers. In order to examine more closely the factors influencing health and pension coverage, we first divided the 10 industries in Exhibit II-3 into four categories (1) Trade, (2) Services, (3) Construction, and (4) Other. We note that the trade, services, and construction industries employed 86.4 percent of workers not covered by pension plans in 1977. We then examined the interrelationship between size and industry in these four industry groupings. Exhibit II-4 shows that, with minor exceptions, small establishments in the trade, services, and

EXHIBIT II-3

HEALTH AND PENSION COVERAGE, BY INDUSTRY, 1977

Industry	Health Only	Pension Only	Both Health and Pension	Neither
Finance	12.1%	1.0%	84.0%	2.9%
Manufacturing-Durable	12.4	0.6	83.9	3.1
Other	16.6	--	80.6	2.8
Transportation	16.8	0.8	76.8	5.7
Manufacturing Non-Durable	21.2	0.6	75.8	2.4
Mining	13.3	1.6	72.3	12.9
Wholesale Trade	29.7	2.1	63.4	4.8
Services	24.1	2.3	56.8	16.8
Construction	26.2	0.8	54.9	18.1
Retail Trade	29.2	2.5	44.0	24.3
Total	21.8%	1.5%	65.1%	11.6%

SOURCE: 1977 Expenditures for Employee Compensation (EEC) Survey, Bureau of Labor Statistics.

EXHIBIT II-4

PERCENTAGE OF ESTABLISHMENTS WITH BOTH HEALTH AND PENSION COVERAGE, BY INDUSTRY AND ESTABLISHMENT SIZE, 1977

	Establishment Size				
	1-25	26-99	100-499	500+	Total
Trade	27%	51%	71%	85%	49%
Services	33	34	68	96	57
Construction	35	72	68	NA	55
Other	51	66	84	95	80
TOTAL	35%	54%	77%	93%	65%

SOURCE: 1977 Expenditures for Employee Compensation (EEC) Survey, Bureau of Labor Statistics.

construction industries have lower coverage rates than small establishments of the same size in the "other" industry groupings. Thus, these data indicate that the trade, services, and construction industries do not have lower coverage levels only because they have a relatively larger proportion of small businesses.

Two other factors contributing to the lower coverage levels in these industries are (1) the high proportion of lower wage employees and (2) the high proportion of non-union employees. For example, 88.2 percent of workers in the trade industry worked in establishments with average wage levels of less than $6 per hour in 1977, and 86.0 percent of them worked in non-unionized establishments. Similarly, in the services industry, there is a high concentration of low wage and non-unionized workers, 74.3 percent and 86.0 percent respectively. The construction industry differs somewhat in its characteristics: first, it is more unionized (34 percent of workers are unionized compared to 14 percent in Services and Trade), and second, only 44 percent of its workers worked in establishments with average wage levels of less than $6 per hour in 1977. In aggregate terms, for all the other industries combined, 73 percent of workers worked in establishments with average wage levels of less than $6 an hour (in 1977), and 61 percent were not unionized.

We then examined coverage for pension benefits by establishment size and wage level. Exhibit II-5 shows that pension coverage increases both with wage level and establishment size. We found that the increase is stronger with respect to establishment size than it is to average wage levels. For example, 18.8 percent of employees in establishments with both (1) average wage levels in 1977 of less than $3 an hour and (2) less than 10 workers were covered by

EXHIBIT II-5

PROPORTION OF WORKFORCE COVERED BY PENSION PLANS, BY WAGE AND SIZE OF ESTABLISHMENT, 1977

	Average Hourly Wage			
Number of Employees	≤ $3.00	$3.00-5.99	$6.00-8.99	$9+
1-9	18.8%	25.5%	59.1%	69.2%
10-25	32.7	36.2	69.6	73.6
26-49	43.3	48.6	79.2	93.4
50-99	44.0	62.9	75.1	78.5
100-499	66.9	78.4	93.2	93.9
500-999	68.8	95.4	98.5	100.0
1,000-2,499	92.4	96.0	94.5	100.0
2,500+	96.3	94.1	96.5	100.0
Total	50.7%	66.3%	85.2%	85.1%

SOURCE: 1977 Expenditures for Employee Compensation (EEC) Survey, Bureau of Labor Statistics.

pension plans compared to 69.2 percent of employees in establishments of the same size but with average wage levels of more than $9 an hour in 1977. In contrast, over 90 percent of employees in establishments with average wage levels of less than $3 an hour in 1977 in the largest establishments had pension coverage. For establishments with more than 1,000 employees, all wage and size categories have more than 90 percent pension coverage.

Exhibit II-6 provides even more detail on the relationship between establishment size, industry, and the average wage level of establishments. It shows that in 1977:

- Except for establishments in which the average hourly wage level was less than $3 in 1977, 90 percent or more of all workers in establishments with 500 or more workers were covered by both pension and health plans in 1977.

- In establishments with 100-499 employees and high average wage rates (over $6 per hour in 1977), coverage levels for both health and pension benefits were 90 percent or more in all industries except the trade industry.

EXHIBIT II-6

COVERAGE BY BOTH PENSION AND HEALTH PLANS, BY INDUSTRY, WAGE LEVEL, AND ESTABLISHMENT SIZE

Industry/Average	Size of Establishment				
Hourly Wage Level (1977)	1-25	26-99	100-499	500+	Total
Trade					
Less than $3	24%	39%	56%	66%	38%
$3-6	25	57	80	91	55
$6-9	49	68	76	100	65
$9+	36	75	100	N/A	63
Services					
Less than $3	18%	30%	53%	89%	42%
$3-6	27	28	62	98	55
$6-9	42	50	93	98	78
$9+	62	70	92	100	74
Construction					
Less than $3	17%	56%	73%	N/A	41%
$3-6	12	45	43	N/A	30
$6-9	53	100	96	N/A	73
$9+	100	99	100	N/A	100
"Other"					
Less than $3	32%	53%	75%	90%	69%
$3-6	38	66	85	94	78
$6-9	66	79	96	97	92
$9+	83	93	89	100	95

SOURCE: 1977 Expenditures for Employee Compensation (EEC) Survey, Bureau of Labor Statistics.

- Establishments with 100-499 employees and with average hourly wage levels of less than $6 in 1977 in the trade and services industries had substantially lower levels of coverage for both types of benefits than similar establishments in other industries.
- The levels of coverage in establishments with less than 100 employees were significantly lower for the trade and services industries for all average wage rate levels.

We then examined the relationship between pension coverage, unionization status, and establishment size. Exhibit II-7 shows that unionization status is extremely highly correlated with pension coverage: over 90 percent of unionized establishments have pension coverage while only 57 percent of non-unionized establishments have pension coverage. It also shows that 90 percent or more of unionized establishments in all establishment size groups have pension coverage. This is in sharp contrast to non-unionized establishments, in which coverage varies greatly by establishment size. One reason for the high coverage rates of small, unionized establishments (and firms) is that they are part of multiemployer plans.

We then examined the distribution of non-covered workers. This allows one to understand the types of workers that are not covered and the characteristics of the establishments in which they work. Exhibit II-8 shows that of the approximately eight million workers in establishments which had neither pension nor health plan coverage in 1977:

- Almost one-half (47.6 percent) of all uncovered workers were in establishments with average wage levels of $3 or less in 1977.
- 65 percent of uncovered workers were in establishments with less than 25 employees.
- Over 85 percent of the uncovered workers were in the trade, services, and construction industries. And, almost 50 percent were in trade and services establishments with 25 or fewer employees.

EXHIBIT II-7

PENSION COVERAGE, BY UNIONIZATION STATUS AND ESTABLISHMENT SIZE, 1977

	Unionization Status of Establishment		
Establishment Size	Union	Non-Union	Total
1-25	91%	32%	37%
26-99	88	48	56
100-499	95	75	78
500+	95	96	95
Total	93%	57%	67%

SOURCE: 1977 Expenditures for Employee Compensation (EEC) Survey, Bureau of Labor Statistics.

EXHIBIT II-8

DISTRIBUTION OF WORKERS NOT COVERED BY EITHER PENSION OR HEALTH PLANS IN 1977

Industry/Average Hourly Wage Level (1977)	Size of Establishment				
	1-25	26-99	100-499	500+	Total
Trade					
Less than $3	17.8%	8.0%	0.8%	0.8%	27.4%
$3-6	12.6	3.7	0	0	16.3
$6+	1.0	0.9	0	0	1.9
Services					
Less than $3	6.9	5.3	1.9	0.8	14.8
$3-6	8.4	4.9	1.9	0	15.2
$6+	1.6	0.1	0	0	1.7
Construction					
Less than $3	1.0	0	0	0	1.0
$3-6	5.1	0.4	0.7	0	6.2
$6+	1.0	0	0.1	0.7	1.8
All Other Industries					
Less than $3	2.5	1.7	0.3	0	4.4
$3-6	5.8	0.7	0.3	0	6.9
$6+	1.5	0.8	0	0	2.3
Total					
Less than $3	28.2	15.0	2.9	1.5	47.6
$3-6	31.9	9.7	2.9	0	44.6
$6+	5.1	1.8	0.1	0.7	7.8
Total	65.2%	26.5%	6.0%	2.3%	100.0%

SOURCE: 1977 Expenditures for Employee Compensation (EEC) Survey, Bureau of Labor Statistics.

Exhibit II-9 shows the distribution of uncovered workers in two groups of establishments: (1) establishments with neither health nor pension benefits; and (2) establishments with health but no pension benefits. It shows that these two groups have substantial differences:

- Workers not covered for either type of benefit are more likely to be in low wage, small establishments (28 percent versus 10 percent), or medium wage, small establishments (32 percent versus 19 percent) than workers covered by health plans but not by pension plans.
- Workers with health but not pension coverage are more likely to be found in low and medium wage, larger establishments (58 percent versus 32 percent) than workers not covered by either type of benefit.

C. FINDINGS FROM REGIONAL SURVEYS

Examination of data from the two regional surveys of small businesses--the SBANE and SMC surveys--provides further insight into the extent of pension and health care coverage in small firms. This evidence, however, must be analyzed with care because the data are not representative of all small businesses.

1. Pension Benefits

Exhibit II-10 summarizes the frequency of pension coverage by firm size from the SBANE and SMC data bases.[1] The exhibit shows that the proportion of firms providing pension benefits to employees was comparable in both surveys: 56 percent of the small firms surveyed by SBANE provided pension benefits to their employees, while 59 percent of the SMC firms reported having pension plans. The percentage of firms with pension benefits is very similar to that found in the aggregate data analysis.

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[1] All firms in these two surveys had less than 500 employees.

EXHIBIT II-9

DISTRIBUTION OF UNCOVERED WORKERS IN 1977 a/

	Workers Covered by Neither Health Nor Pension Plans (% of Total)	Workers with Health, But No Pension Coverage (% of total)
Low Wage, Small Establishments		
Trade, Services, Const.	2,000 (26%)	1,251 (9%)
Other	193 (2%)	278 (2%)
Subtotal	2,193 (28%)	1,528 (10%)
Low Wage, Larger Establishments		
Trade, Services, Const.	1,364 (18%)	2,417 (17%)
Other	152 (2%)	1,117 (8%)
Subtotal	1,516 (19%)	3,534 (24%)
Medium Wage, Small Establishments		
Trade, Services, Const.	2,032 (26%)	2,075 (14%)
Other	453 (6%)	756 (5%)
Subtotal	2,485 (32%)	2,832 (19%)
Medium Wage, Larger Establishments		
Trade, Services, Const.	903 (12%)	2,889 (20%)
Other	81 (1%)	2,120 (14%)
Subtotal	984 (13%)	5,009 (34%)
Higher Wage Establishments		
Trade, Services, Const.	425 (5%)	1,309 (9%)
Other	180 (2%)	416 (3%)
Subtotal	605 (8%)	1,725 (12%)
TOTAL	7,783 (100%)	14,628 (100%)

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a/ Low wage defined as workers in establishments with average wage levels of less than $3 per hour in 1977. Medium wage defined as between $3 and $6 per hour in 1977 and higher wage defined as greater than $6. Small establishments defined as 1-25 workers. Larger establishments include all other establishments.

SOURCE: 1977 Expenditures for Employee Compensation (EEC) Survey, Bureau of Labor Statistics.

EXHIBIT II-10

DISTRIBUTION OF PENSION COVERAGE BY FIRM SIZE, SBANE AND SMC SURVEYS, 1982 a/

Firm Size	SBANE (n=175) Pension Coverage	SBANE (n=175) No Pension Coverage	SMC (n = 216) Pension Coverage	SMC (n = 216) No Pension Coverage
1-4	1 (14%)	6 (86%)	4 (36%)	7 (64%)
5-9	4 (33%)	8 (67%)	10 (37%)	17 (63%)
10-19	15 (40%)	23 (60%)	11 (35%)	20 (65%)
20-49	29 (62%)	18 (38%)	46 (59%)	32 (41%)
50-99	23 (66%)	12 (34%)	29 (76%)	9 (24%)
100-249	19 (73%)	7 (27%)	23 (92%)	2 (8%)
250-499	5 (83%)	1 (17%)	5 (83%)	1 (17%)
TOTAL	98 (56%)	77 (44%)	128 (59%)	88 (41%)

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a/ Information not available for 24 firms in the SMC Survey.

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits and the Smaller Manufacturers Council of Pittsburgh's (SMC) 1982 Wage and Fringe Benefit Survey.

The SBANE and SMC data confirm the pattern of pension coverage by firm size found in the aggregate data analysis: as the size of the firm increases, the likelihood of offering pension benefits increases. For example, 36 percent of the SMC firms with less than 20 employees offered retirement plans to their employees, compared to 90 percent of those firms with 100 or more employees. Similarly, the SBANE data show that 35 percent of the firms with under 20 employees offered pension benefits, while 75 percent of the firms with 100 or more employees offered pension benefits.

On the basis of the two regional data bases, it appears pension coverage increases rapidly after firms reach the size of 20 employees. For example, in the SBANE survey, pension coverage jumps from 40 percent for firms in the size range 10-19 employees to 62 percent coverage in the size range 20-49 employees. Similarly, SMC data show a rise of 24 percent between the two size categories--from 35 percent coverage for the size group of 10-19 employees, to 59 percent coverage in the size group of 20-49 employees.

Exhibit II-11 presents evidence from the SMC regional survey on the extent of coverage across various industries. Basic industrial manufacturers--metal processors, metal fabricators, machine shops and glass/ceramics manufacturers--tended to have the highest proportion of retirement plan coverage within the SMC data base. Similar to the aggregate data analysis, the SMC data suggest that pension coverage in small firms (under 500 employees) is closely linked to unionization. In fact, many of the plans were instituted as part of a union contract. For example, 74 percent of those firms surveyed by SMC reported that their pension plan was part of a union contract.

The SMC survey indicates that most plans of small businesses cover both salaried and hourly employees. Exhibit II-12 shows that 77 percent of the small businesses with pension plans covered both salaried and hourly employees. A small proportion of firms within the SMC sample indicated that their plan covered only hourly (16 percent) or only salaried (7 percent) workers. Overall, SMC data indicate that pension plans in small firms tend to cover all full-time salaried and hourly employees.

EXHIBIT II-11

DISTRIBUTION OF PENSION COVERAGE BY INDUSTRY, SMC SURVEY, 1982

Industry	Pension Coverage	No Pension Coverage
Glass/Ceramics	14 (78%)	4 (22%)
Metal processing	20 (69%)	9 (31%)
Metal fabricating	27 (63%)	16 (37%)
Machine shop	28 (61%)	18 (39%)
Processor of metals	12 (55%)	10 (45%)
Sales/Service	6 (50%)	6 (50%)
Electrical	5 (42%)	7 (58%)
Plastics/Chemicals	7 (39%)	11 (61%)
Other	9 (56%)	7 (44%)
Total	128 (59%)	88 (41%)

SOURCE: The Smaller Manufacturer's Council of Pittsburgh's (SMC) 1982 Wage and Fringe Benefit Survey.

EXHIBIT II-12

ELIGIBILITY FOR PENSION BENEFITS BY TYPE OF WORKERS, SMC SURVEY, 1982

Type of Worker	Number of Firms	Percent
Both Salaried and Hourly	98	77%
Salaried Only	9	7
Hourly Only	21	16
Total	128	100%

SOURCE: The Smaller Manufacturer's Council of Pittsburgh's (SMC) 1982 Wage and Fringe Benefit Survey.

2. Health Benefits

Virtually all firms questioned in the SBANE and SMC surveys had some type of health benefits for their employees. For example, 174 of the 175 firms with less than 500 employees in the SBANE survey had some form of health insurance. Hence, little can be said from the regional surveys about how firm size affects whether firms offer health benefits.

However, the SBANE and SMC surveys indicate that firm size does appear to affect the type of health benefits offered. For example, Exhibit II-13 shows that 43 percent of the firms in the SMC Survey and 32 percent of small firms in the SBANE Survey offered dental benefits and that the proportion of firms offering dental benefits increases as firm size increases.

D. FINDINGS FROM ON-SITE CASE STUDIES AND TELEPHONE DISCUSSIONS

We interviewed 18 employers about the reasons they did or did not provide pension and health benefits. Of the fifteen small firms interviewed by telephone, eight currently had pension plans. All 15 of these firms had health care plans. The three firms selected for on-site case studies had both pension and health care coverage.

1. Reasons for Not Offering Pension Benefits

During the telephone interviews, small employers without pension coverage were asked questions in four general areas relating to their decision not to offer plan coverage to identify:

- reasons that they did not have a pension plan;
- factors that would be most important in the firm's decision to provide pension benefits in the future;
- whether (and how) government regulation or paperwork involved in setting-up and administering a plan affects the firm's decision; and
- whether the firm currently had plans to establish a pension or profit sharing plan during the upcoming year.

EXHIBIT II-13

DISTRIBUTION OF DENTAL COVERAGE BY FIRM SIZE, SBANE AND SMC SURVEYS (1982)

	SBANE		SMC	
Firm Size	Dental Coverage	No Dental Coverage	Dental Coverage	No Dental Coverage
1-4	1 (14%)	6 (86%)	1 (7%)	14 (93%)
5-9	3 (25%)	9 (75%)	13 (35%)	17 (65%)
10-19	8 (21%)	30 (79%)	8 (24%)	25 (76%)
20-49	15 (32%)	32 (68%)	37 (45%)	45 (55%)
50-99	14 (40%)	21 (60%)	17 (45%)	21 (55%)
100-249	10 (39%)	16 (61%)	17 (68%)	8 (32%)
250-500	4 (67%)	2 (33%)	5 (83%)	1 (16%)
TOTAL	56 (32%)	119 (68%)	98 (43%)	131 (57%)

SOURCE: The Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits and the Smaller Manufacturer's Council of Pittsburgh's (SMC) 1982 Wage and Fringe Benefit Survey.

The seven employers without plans cited several reasons for not providing this benefit. The most frequently cited reason was that the firm was not sufficiently profitable to justify establishment of a plan. For example, three of the interviewees responded in the following manner:

- "We're not profitable enough on a yearly basis";
- "Haven't been highly profitable during recent years"; and
- "Money has not been available for setting up a plan".

In addition to the lack of firm profitability, interviewees cited several other reasons for not having a retirement plan, including:

- demographic characteristics of employees, e.g., one interviewee indicated that the firm's employees were relatively young and therefore preferred to receive higher income (through increased salary) than employee benefits;
- complexity and costs of setting up a plan, as well as the need to obtain expert advice;

- lack of interest on the part of the employees;
- existence of bonuses for employees which could be placed in an IRA by the employee;
- complexity of laws governing pension plan formation and administration, e.g., one employer stated that he found it difficult to stay up with and understand regulations governing pensions under ERISA and that he had some concern about overhead costs involved in filling out forms to comply with ERISA; and
- general financial and economic conditions, e.g., one interviewee indicated that under the current inflationary trends that he preferred to give the employees cash now rather than later.

One interviewee formerly had a plan, but decided to terminate it when ERISA came into existence. The owner-operator cited several factors for terminating the plan:

- The employer found that ERISA's plan trustee provisions were too rigorous. He noted that under these provisions that he (and the plan trustees) no longer wanted responsibility for plan administration.
- The company attorney estimated that it would cost $2,500 to change the plan to conform with ERISA requirements. He felt that this was excessive.
- He did not see any real benefit to having the plan--commenting that employees were no more loyal or hardworking because of the plan and generally took the plan for granted.
- He found that the cost of the plan was getting greater as the salaries of employees increased.

The most important factor governing the future decisions of these firms to establish a retirement plan was financial considerations--specifically, firm profitability. Several firms indicated that "no factor" would influence their decision to establish a plan--they were not interested in setting up a plan. One interviewee indicated that he would only initiate a plan that required mandatory contributions by both the employer and the employee, and that yielded equal benefits across all types of employees.

Interviewees were split over whether government regulation or paperwork involved in setting up a plan affected their decision not to offer pension benefits. Those that felt that regulations were a factor (four of seven interviewees) pointed to the complexity of the laws and the added paperwork involved in on-going administration. For example, one employer indicated that government regulation did not directly affect his decision to offer benefits, but that he did not "clearly understand the regulations" and that these regulations would "more than likely delay future decisions" to establish a plan. Another interviewee noted that the advent of ERISA had made laws governing pensions complex and that he was less likely to establish a plan because he did not want to pay someone in his company to complete required paperwork when he was trying to cut back on overhead. None of the seven firms indicated that they had plans in the upcoming year to establish a retirement plan.

2. Reasons for Offering Pension Benefits

Telephone discussions with eight employers with pension plans, on-site case studies of three small employers and interviews with two plan consultants provided evidence on why small firms decide to provide pension benefits. The eight telephone interviewees cited a variety of reasons for initiating their pension plan, including:

- firm profitability at the time of plan formation and the desire to avoid corporate taxes on profits;
- a desire to remain competitive in the labor market;
- that the plan was the result of union negotiations;
- to provide for the future of employees and protect them at the time of retirement; and
- to share firm profits with employees.

Similar reasons for plan establishment were identified during the three on-site case studies and interviews with plan consultants. For example, one firm cited four major reasons for plan establishment:

- to provide for the owner-operator and employees in case of future company bankruptcy;
- because the owner-operator (aged 48) and most employees (in their 30's) were approaching the age at which they felt it was important to set aside funds for retirement;
- because the company had recently become sufficiently profitable to set aside funds; and,
- because of tax advantages (i.e., avoidance of corporate and personal taxation) associated with retirement plans.

A representative of an actuarial firm involved in the administration of retirement plans for thirty small business firms felt that the overriding reason for the establishment of a plan by the firms he dealt with was to avoid taxation by sheltering income (particularly for the owner-operator). Other, secondary reasons for plan formation, included concern over providing for employees' retirement, the desire to provide for the owner-operator's retirement, and a desire to reward long-service employees. A second actuary supported these assertions--indicating that small firms set up plans when they became sufficiently profitable that they were concerned about the implications of taxation. This actuary noted that firms generally set up plans during the final month of their fiscal year, when they knew the level of profitability. While tax considerations were the central consideration in setting up most plans, the actuary identified several other reasons--including concerns on the part of the owner about personal retirement income and concern over the long term welfare of the employees.

3. Health Benefits

All firms interviewed by telephone (fifteen) and the three on-site case study firms offered health benefits to their employees. Reasons that were cited by employers for originally establishing a health care plan were similar to those given for offering retirement benefits:

- to be competitive in the market place, both in terms of recruiting and retaining personnel;
- to take care of the family needs of the employees, as well as the owner-operator;
- because health coverage is a tax deductible expense; and
- in response to employee/union negotiations.

In general, the provision of health benefits by the firm was a benefit that the employer expected to provide and the employees expected to receive. For example, one employer commented, "it's the sort of thing you do for employees"; another owner-operator felt that employees were entitled to this benefit which had become "almost a required perk".

III. CHARACTERISTICS OF SMALL PENSION AND HEALTH PLANS

A. OVERVIEW

This section presents information about the characteristics of pension and health care benefits in small firms. Using aggregate and regional data analysis, as well as interviews with small employers and pension plan experts, we examined the provisions of benefit plans.

In analyses of aggregate data, we found that small firms are more likely to have defined contribution plans than defined benefit plans.[1] We found that firms with under 100 employees are significantly more likely to have defined contribution plans. For example, 73 percent of the firms with fewer than 25 employees and 67 percent of the firms with 25-99 employees had only defined contribution plans--compared to just seven percent of firms with 100 or more employees. We also found that small firms are most likely to have profit sharing plans. As might be expected, small firms are substantially less likely than firms over 100 employees to have more than one retirement plan.

In our aggregate data analysis of the ICF Retirement Plan Provisions Data Base, we also found:

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[1] Defined contribution plans guarantee no specific benefit at retirement, but rather provide whatever a participant's allocated portion of accumulated sponsor contributions will purchase. The size of the sponsor's annual contribution may vary depending on factors such as the participant's salary, plan type, and contribution formula and, in certain plans, how much each participant contributes and/or company profits. Defined benefit plans provide a prespecified benefit at retirement. The plan sponsor must contribute a sufficient amount each year to make sure that sufficient funds are available when each participant retires.

- Few firms under 100 employees sponsor ESOP or TRASOP plans.[1] In addition, small firms are unlikely to offer thrift/savings plans. However, they were much more likely than large firms to offer money purchase defined contribution plans.

- The likelihood of integration of defined benefit plans increases as firm size increases--while about half of the defined benefit plans in firms under 25 employees are integrated, 72 percent of defined benefit plans in firms over 100 employees are integrated. This is found because many small firms contribute to multiemployer plans which are not integrated with Social Security.[2]

- Firms under 100 employees with defined benefit plans are less likely to have early retirement benefits.

Analysis of the ICF Health Plan Data Base revealed that:

- Workers covered by small health plans are less likely to have family coverage than workers covered by large plans.

- Small firms tend to have less generous types of benefits than large firms--particularly in areas of dental coverage and maternity benefits.

- Small firms are more likely to require employee contributions than large firms.

- Firms with 26-100 employees are most likely to have deductibles and co-insurance provisions.

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[1] ESOPs are Employee Stock Ownership Plans. These are a special type of defined contribution plan in which, instead of cash deposits, the employer transfers a portion of the ownership of the company to the employees, i.e., gives the trust fund for employees stock in the company. The Tax Reduction Act of 1975 provided a tax credit to employers who provide ESOPs. Plans qualifying under this law are called Tax Reduction Act Stock Ownership Plans or TRASOPs. See Internal Revenue Code Section 415(c)(6).

[2] An "integrated" pension plan is one that is linked with social security -- that is, plan benefits are reduced to take into account the portion of retirement income that pensioners receive from social security.

From our analyses of regional data and interviews with small employers and pension consultants who serve small businesses we found the following:[1]

- Confirmation that small firms are more likely than large firms to have only one pension plan and that the most common type of plan found in small firms is a profit sharing plan. For example, SBANE data indicate that 60 percent of the firms with under 500 employees offer a profit sharing plan by itself or in combination with another plan.

- Interviews with small employers and pension plan consultants suggested that selection of a profit sharing plan is, in part, due to their greater flexibility in making contributions to the pension fund, as well as ease of start-up and on-going administration.

- About three-quarters of the firms interviewed by SBANE had a minimum age requirement and 93 percent had some type of service requirement for employee plan participation. The most frequently used combination of age/service requirements among small firms is the ERISA maximum--25 years of age with one year of service.

- The most frequent type of vesting provision found in firms under 500 employees--occurring in 21 percent of the firms interviewed by SBANE--begins at one year of service and is completed after 10 years of service. Fifty-five percent of the SBANE firms had plans that provided full vesting at 10 years.

- Both SBANE and SMC data indicate that small firms are most likely to offer Blue Cross/Blue Shield health coverage.

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[1] Telephone interviews were conducted with 15 small firms in the Cleveland and Pittsburgh areas; on-site case studies were conducted with 3 small employers in the Cleveland area; and telephone interviews were conducted with representatives of two major pension consulting firms in the Washington area. The Small Business Association of New England (SBANE) surveyed 176 small business firms in the Boston area in 1982 and the Smaller Manufacturing Council (SMC) interviewed 242 small firms in the Pittsburgh area. For more details on methodology employed in this study see Chapter I (Methodology) and Appendices A-D.

- Health Maintenance Organization (HMO) coverage is provided in 10 percent of the SBANE firms and 15 percent of the SMC firms. Only a small percentage of firms use self-insurance.
- About 85 percent of the SBANE firms had some form of deductible--usually $100. About 80 percent of the SBANE firms had co-insurance--under most plans the insurance paid 80 percent of medical expenses and the employee paid the remaining 20 percent.

B. PENSION BENEFITS

1. Findings from National Aggregate Data Analysis

We analyzed the ICF Retirement Plan Provisions Data Base to examine the differences in the types of retirement plans between small firms and large firms. The ICF Retirement Plan Provisions Data Base contains data on the characteristics of a representative sample of retirement plans. It is stratified by industry, firm size, and multi/single employer status. It provides plan provision data for both the primary and supplemental defined benefit and defined contribution plans offered by public and private sector sponsors. For each of these sponsors, ICF obtained Summary Plan Description (SPD) data on their retirement plans. The data base includes all relevant plan provisions for participation, vesting, hours crediting, retirement, death, disability, joint and survivors benefits and social security integration.

Our examination of these data, as shown in Exhibit III-1, indicates that:

- First, small firms are more likely to have defined contribution plans than defined benefit plans. Approximately, 70 percent of workers in small firms are covered by defined contribution plans. In larger firms, approximately 60 percent of workers are covered by defined contribution plans--although most of the defined contribution plans in large firms are supplemental to defined benefit plans. This preference by small firms for defined contribution plans is due, in part, to their desire to control the costs of the plan.

EXHIBIT III-1

THE PERCENTAGE OF WORKERS COVERED BY DIFFERENT TYPES OF PENSION PLANS, BY FIRM SIZE, 1982

	Firm Size		
Type of Coverage	Less than 25	25-99	100 Or More
Defined Contribution Only	73%	67%	7%
Defined Benefit Only	25	32	38
Both Defined Benefit and Defined Contribution	2	1	54
TOTAL	100%	100%	100%

SOURCE: ICF Retirement Plan Provisions Data Base.

- Small firms are likely to have only one plan. In contrast, 54 percent of employees in large firms work for employers with both a defined benefit and a defined contribution plan.
- The very smallest firms (1-24 employees) are more likely to have defined contribution plans than firms with 25-99 employees.

Exhibit III-2 provides data on the types of defined contribution plans sponsored by small firms. It shows that of firms with some type of defined contribution plan, small firms are most likely to have profit sharing plans. This is in sharp contrast to the defined contribution plans of larger firms, which are predominantly savings plans. This reflects the fact that most of the defined contribution plans for large firms are supplemental plans, while for small firms the defined contribution plans are the primary plan. It also reflects the desire of small employers to have plans with controllable costs. Profit sharing plans are especially appropriate because they allow an employer to have low payments (or none at all) in years of low profitability and higher contributions in years of greater profitability. Exhibit III-2 also shows that few small firms sponsor ESOPs or TRASOPs. Finally, it shows that about

EXHIBIT III-2

PERCENTAGE DISTRIBUTION OF WORKERS IN DEFINED CONTRIBUTION PLANS, BY TYPE OF DEFINED CONTRIBUTION PLAN AND FIRM SIZE, 1982

Type of Defined Contribution Plan	Firm Size Less than 25	 25-99	 100 Or More
Profit Sharing	65%	56%	27%
Thrift/Savings	5	3	47
Profit Sharing/Savings	3	3	8
Money Purchase	26	38	2
ESOP/TRASOP	a/	a/	16
TOTAL	100%	100%	100%

a/ Less than 0.5 percent.

SOURCE: ICF Retirement Plan Provisions Data Base.

one-quarter of workers in the smallest firms have money purchase plans, while 38 percent of workers in firms with 25-99 employees are covered by money purchase plans.[1]

Exhibit III-3 examines how defined benefit plans are integrated with social security benefits. It shows that, surprisingly, the likelihood of integration increases as plan size increases. This is found because many of the small firms contribute to multiemployer plans--the vast majority of which

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[1] A money purchase plan is an arrangement for allocating pension funds to individual participants under defined contribution plans. Under a money purchase plan, contributions are allocated through the maintenance of individual employee accounts. Generally, contributions are expressed as a percentage of covered payroll.

EXHIBIT III-3

PERCENTAGE DISTRIBUTION OF WORKERS IN DEFINED BENEFIT PLANS, BY TYPE OF INTEGRATION PROVISIONS AND FIRM SIZE, 1982

	Firm Size		
	Less than 25	25-99	100 Or More
Not Integrated	51%	47%	28%
Integrated			
"Offset"	28	25	45
"Step-Up"	21	28	27
Subtotal	49	53	72
TOTAL	100%	100%	100%

SOURCE: ICF Retirement Plan Provisions Data Base.

are not integrated with social security. If we look only at single employer plans, small firms are more likely to have integrated defined benefit plans than large firms. This exhibit also shows that large, integrated plans are more likely to be "offset" plans than "step-up" plans, while small plans are almost equally split between these two methods of integration.[1]

Exhibit III-4 examines the types of plan formulas used in the defined benefit plans. It shows that the plans of small employers are more likely to be unit benefit plans than the plans of large employers.[2] This surprising

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[1] "Offset" and "step-up" represent two different methods for integrating pension benefits with social security benefits. Under the "offset" approach, an employees's benefit is reduced or offset by a stated percentage of such employee's old-age insurance benefit under the Social Security Act. Under the "step-up" approach the formula used to calculate the pension benefits increases (or "steps-up") when a certain level of income is reached.

[2] Unit benefit plans provide a specific dollar benefit for each year of service. Thus, the benefit is independent of pay but is a function of service. For example, a plan may pay $200 annual benefit for each year of service. In this case a retiree who has 30 years of service at retirement would receive a benefit of $6,000 per year ($200 times 30 years).

EXHIBIT III-4

DISTRIBUTION OF WORKERS IN DEFINED BENEFIT PLANS, BY TYPE OF BENEFIT FORMULA AND FIRM SIZE, 1982

	Firm Size		
Benefit Formula	Less than 25	25-99	100 Or More
Salary Related	53%	55%	79%
Flat Dollar	3	a/	1
Unit	44	45	20
TOTAL	100%	100%	100%

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a/ Less than 0.5 percent.

SOURCE: ICF Retirement Plan Provisions Data Base.

finding is explained by the fact that many small employers contribute to multiemployer plans, which are overwhelmingly unit benefit plans. If we examine only single employer plans, the vast majority of small plans are salary-related plans. The exhibit also shows that few workers are covered by flat benefit formulas.

Our analysis of defined benefit plans reveals that less than five percent of the plans of small employers either require or allow employee contributions. Exhibit III-5 shows that the situation is quite different for defined contribution plans. In small, defined contribution plans, approximately 40-50 percent of workers are covered by plans which either require or allow contributions. The situation is quite different for large defined contribution plans, primarily because these plans are more likely to be supplementary plans.

EXHIBIT III-5

DISTRIBUTION OF WORKERS IN DEFINED CONTRIBUTION PLANS BY EMPLOYEE CONTRIBUTIONS AND FIRM SIZE, 1982

Employee Contributions	Firm Size Less than 25	 25-99	 100 Or More
None	50%	38%	10%
Required	6	9	a/
Not Required, But No Employer If No Employee	5	12	69
Optional	40	41	21
TOTAL	100%	100%	100%

a/ Less than 0.5 percent.

SOURCE: ICF Retirement Plan Provisions Data Base.

Exhibits III-6 and III-7 present the vesting provisions in defined benefit and defined contribution plans respectively. These exhibits show that:

- About 70 percent of workers in small, defined benefit plans are covered by plans with 10-year "cliff" vesting.[1] A higher percentage (77 percent) of workers in large, defined benefit plans are covered by 10 year "cliff" vesting provisions.
- The high percentage of small firms with ten year cliff vesting is due to the fact that many small firms contribute to multiemployer plans which use this type of vesting.
- Vesting provisions in defined contribution plans are more generous than in defined benefit plans. In other words, defined contribution plans generally provide for a higher vesting percentage for any given number of years of service. Participants become partially or fully vested sooner in defined contribution plans than in defined benefit plans.

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[1] Cliff vesting means there is a "cliff" in the graph of the percent vested versus years of service. 10-year cliff vesting provides no vesting prior to 10 years and 100 percent vesting thereafter. There is a cliff at 10 years.

EXHIBIT III-6

DISTRIBUTION OF WORKERS IN DEFINED BENEFIT PLANS, BY VESTING PROVISIONS AND FIRM SIZE, 1982

Vesting Type/Years Required To Fully Vest	Firm Size		
	Less than 25	25-99	100 Or More
"Cliff" Vesting			
1-4 Years	7%	4%	a/
5-9 Years	5%	2%	4%
10 Years	70%	67%	77%
Graded Vesting			
10 Or Less	14%	20%	13%
More Than 10	3%	6%	6%
Total	100%	100%	100%

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a/ Less than 0.5%.

SOURCE: ICF Retirement Plan Provisions Data Base.

EXHIBIT III-7

DISTRIBUTION OF WORKERS IN DEFINED CONTRIBUTION PLANS, BY VESTING PROVISIONS AND FIRM SIZE, 1982

Vesting Type/Years Required To Fully Vest	Firm Size Less than 25	 25-99	 100 Or More
"Cliff" Vesting			
Immediate	a/	a/	32%
1-9 Years	11%	10%	18%
10 Years	4%	6%	a/
Graded Vesting			
Less Than 10	17%	15%	20%
10 Years	35%	36%	4%
More Than 10 Years	33%	32%	10%
Other	a/	a/	17%
Total	100%	100%	100%

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a/ Less than 0.5%.

SOURCE: ICF Retirement Plan Provisions Data Base.

- The vesting provisions of small, defined contribution plans are significantly less generous than those of larger, defined contribution plans. This is primarily because the defined contribution plans of large firms are more likely to be supplemental plans, such as thrift or savings plans, which typically have fast vesting.

We also used the ICF Retirement Plan Provisions Data Base to examine the early retirement provisions of defined benefit plans. We found that approximately 85-90 percent of workers in small firms with defined benefit plans are covered by plans with early retirement provisions. In contrast, almost 100 percent of large firms with defined benefit plans have early retirement provisions.

2. Findings from Regional Surveys

The SBANE survey provides considerable detail on the characteristics of pension plans in small firms and confirms the findings of the aggregate data analysis in the previous section. Exhibit III-8 shows that small firms were most likely to have only one plan. It also shows that small firms are most likely to have a profit sharing plan. Seventy-eight percent of the small firms surveyed by SBANE had one plan; 22 percent had more than one plan. Similar to the findings from our aggregate analysis, the most common type of plan was a profit sharing plan--in 41 percent of the firms (and 52 percent of firms with only one plan). Overall, nearly 60 percent of the firms offered a profit sharing plan by itself or in combination with another type of plan. A single defined benefit plans was offered in 26 percent of the SBANE firms. Other types of defined contribution plans were found in nine percent of the firms; and just three percent of the small firms offered a thrift plan by itself. None of the firms in this survey reported having stock bonus or

EXHIBIT III-8

TYPE OF PENSION PLAN, SBANE SURVEY, 1982

Type of Plan	Number of Firms	Percentage of Firms
Firms with One Plan	73	78%
Defined Contribution	49	52%
Profit Sharing	38	41%
Thrift Plan	3	3%
Other Defined Contribution	8	9%
Defined Benefit	24	26%
Firms with More Than One Plan	20	22%
Defined Benefit and Profit Sharing	8	9%
Defined Benefit and Other Defined Contribution	4	4%
Two Defined Contribution	8	9%
Total	93	100%

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

target benefit plans. The most common combination of plans was a profit sharing plan with either a defined benefit plan (nine percent of the firms) or another defined contribution plan (nine percent of the plan firms).

Exhibit III-9 shows that among the SBANE survey firms, firm size had little impact on the type of plan. One possible explanation for the lack of a relationship between firm size and type of plan is that the sample of firms is not representative and is small.

Exhibit III-10 displays the various combinations of age and service requirements used by firms within the SBANE survey. Looking first at minimum age requirements (i.e., across the rows of the table), 73 percent of the firms had an age requirement for participation. The most frequent type of age requirement--occurring in 55 percent of the firms--was that employees be 25 years of age. Analyzing minimum service requirements (i.e., down the columns), shows that 93 percent of the firms had some type of service requirement. Most frequently--in two-thirds of the firms--this requirement took the form of a one-year minimum service requirement. One year of service was frequently defined by 1,000 hours of work for the firm. Finally, an examination of the age and service requirements together reveals that just six percent of the firms had neither an age nor service requirement. The most frequently used combination of age/service requirements was the ERISA maximum--that the employee be 25 years of age with one year of service.

Exhibit III-11 provides evidence on the vesting provisions among firms in the SBANE survey with pension plans. Looking at evidence on the start of vesting (across the rows of the table), about 40 percent of plans had vesting which either started immediately or after one year of service. About 90 percent of the firms started vesting after four years or less. Examining evidence on the completion of vesting (looking down the columns), 55 percent

EXHIBIT III-9

DISTRIBUTION OF PENSION PLANS BY FIRM SIZE, SBANE SURVEY, 1982 a/

Firm Size	Defined Benefit	Defined Contribution	Profit Sharing	Thrift Plan	Total
1-4	1 (50%)	0	1 (50%)	0	2 (100%)
5-9	1 (25%)	1 (25%)	2 (50%)	0	4 (100%)
10-19	7 (37%)	3 (16%)	9 (47%)	0	19 (100%)
20-49	7 (24%)	4 (14%)	16 (55%)	2 (7%)	29 (100%)
50-99	7 (25%)	4 (14%)	15 (54%)	2 (7%)	28 (100%)
100-249	9 (41%)	4 (18%)	8 (36%)	1 (5%)	22 (100%)
250-499	4 (57%)	0 (0%)	2 (29%)	1 (14%)	7 (100%)
	36 (32%)	16 (14%)	53 (48%)	6 (5%)	111 (100%)

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a/ Information was not available for seven firms.

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

EXHIBIT III-10

DISTRIBUTION OF PARTICIPATION REQUIREMENTS, SBANE SURVEY, 1982 a/

	Service Requirement (Years)						
Age Requirement	No Requirement	≤1	1	2	3	Total Firms	%
No Requirement	5	5	10	1	3	24	27%
Age 18	0	0	3	0	0	3	3%
Age 21	0	2	5	1	0	8	9%
Age 23	0	0	3	0	0	3	3%
Age 24	0	0	2	0	0	2	2%
Age 25	1	8	37	3	0	49	55%
Total Firms	6	15	59	5	3	89	N/A
Percent	7%	17%	67%	6%	3%	N/A	100%

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a/ Nine firms with pension plans did not indicate whether they did or did not have age or service requirements.

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

EXHIBIT III-11

TYPES OF VESTING SCHEDULES, SBANE SURVEY, 1982 a/

	Vesting Completion (Years)								
Start of Vesting	Immediately	1-4	5	6-9	10	11-14	15	Number of Firms	Percent
Immediately	3	0	0	0	5	1	0	9	11%
1 Year	--	1	5	0	17	1	0	24	30%
2 Years	--	0	0	3	3	1	0	7	9%
3 Years	--	1	1	4	6	0	0	13	16%
4 Years	--	1	0	1	8	8	0	18	23%
5 Years	--	--	1	0	3	0	3	7	9%
10 Years	--	--	--	--	2	0	0	2	3%
Total	3	3	7	8	44	11	4	80	N/A
Percent	4%	4%	9%	10%	55%	14%	5%	N/A	100%

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a/ Information not available for 18 firms that had plans.

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

of the firms had plans that provided full vesting at 10 years--although few had 10 year cliff vesting, the most common vesting provision among large plans. Looking at the start and completion of vesting together, the most frequent vesting provision among the SBANE firms--occurring in 21 percent of the firms--began at one year of service and was completed after 10 years of service.

The SBANE survey also examined several other characteristics of pension plans in small firms, including: Social Security integration; loan/withdrawal provisions; and the method of benefit payment. As Exhibit III-12 shows, one-third of the firms in the SBANE pension survey had plans which were integrated with Social Security. Other analyses of the SBANE data indicated that firms under 100 employees in the SBANE survey were no more likely to integrate benefits than firms with over 100 employees.

EXHIBIT III-12

SOCIAL SECURITY INTEGRATION, LOAN/WITHDRAWAL, AND PAYMENT OF BENEFITS, SBANE SURVEY, 1982

Plan Characteristics	Number of Firms	Percentage of Firms
A. Social Security Integration a/		
Yes	29	33%
No	59	67%
B. Loan/Withdrawal Provision b/		
Yes	27	32%
No	57	68%
C. Payment of Benefits c/		
From Fund	55	64%
Purchase of Annuities	9	10%
Both	17	20%
Other	5	6%

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a/ Information not available for 10 firms.
b/ Information not available for 14 firms.
c/ Information not available for 12 firms.

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

About one-third of the plans (32 percent) in the SBANE survey had loan/withdrawal provisions.

The SBANE data also indicate that most firms within the SBANE survey made payment of plan benefits to participants directly from the pension fund (64 percent of the firms). Twenty percent of these firms provided benefits both directly from the fund and through the purchase of annuities. Examination of the type of payment mechanism by plan type did not result in any significant differences across plan types.

Exhibit III-13 presents the types of investments made with plan assets. Over half (52 percent) of the firms invested plan assets in two or more of the types of investments listed in Exhibit III-13. The three most frequent forms of investments were: cash accounts (34 percent of firms); common stocks (31 percent) and bonds (31 percent).

3. Findings from On-Site Case Studies and Telephone Interviews

A major objective of the on-site case studies and telephone interviews was to examine closely the nature of plans and reasons for establishment of particular types of plans. Exhibit C-1, in Appendix C, details characteristics of pension plans for eight firms that were part of the telephone interviews. Exhibits A-1, A-2, A-3 in Appendix A, detail characteristics of plans in the three on-site case studies.

Four of the eleven firms had two pension plans. Similar to the SBANE survey findings, profit sharing plans were the most frequent type of plan--7 of 11 firms (63 percent) of the firms had this type of plan. Interviewees gave several reasons for selecting profit sharing plans. One major reason given was that a profit sharing plan involved the least amount of reporting and on-going administration of the major types of plans. For example:

EXHIBIT III-13

TYPES OF PLAN INVESTMENTS, SBANE SURVEY, 1982 a/

Types of Investments	Number of Firms	Percent of Firms
Life Insurance Contracts	14	17%
Insurance Company Investments	20	24%
Common Stocks	26	31%
Bonds	26	31%
Cash Accounts	34	40%
Real Estate	5	6%
Market Funds	19	23%
Other	23	27%

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a/ Information not available for 14 firms; percentages are based on 84 firms.

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

- One interviewee felt that in terms of administration and reporting a profit sharing plan was the "least of evils".
- A second interviewee commented that a profit sharing plan allowed his firm to avoid the restrictions and reporting requirements of ERISA to the greatest extent possible.
- A third interviewee stated that he formerly had two plans--a defined benefit plan and a profit sharing plan--but dropped the former plan when ERISA went into effect because of the cost of meeting ERISA's requirements. He retained the profit sharing plan because the costs of meeting ERISA's requirements for defined contribution plans were substantially lower than for defined benefit plans.

A second major set of reasons for adopting a profit sharing plan is that this type of plan provides the greatest flexibility in terms of making contributions to the pension fund. Several owner-operators stated that under a profit sharing plan, they made a determination of the level of the contribution (at the end of the year) based on the firm's profitability. If the firm did not have a profitable year, then the owner-operator did not have to make a contribution. For example, one owner-operator stated that he selected a profit sharing plan over other types of plans so that he could avoid "getting trapped" into bankruptcy by the plan during bad years.

A final reason given for the selection of a profit sharing plan was that it was the best type of plan for the employees--permitting the firm to easily distribute profits during peak years to employees.

The next most common type of plan was a defined benefit plan--selected by five of the eleven firms. Firms that chose this type of plan gave several reasons, including:

- One interviewee felt that this type of plan was the least "risky" from the employees point of view.
- A second interviewee stated that the defined benefit plan was a result of union negotiations. The union felt that the employees would benefit from knowing exactly what they would receive at the time of retirement.

- A third owner-operator said that a financial planning study had recommended the formation of a defined benefit plan. This type of plan provided a more substantial benefit to the older, more highly compensated owner-operator than other types of plans.

Finally, two firms interviewed selected a money purchase plan. A major reason given by one firm for the selection of a defined contribution plan was that this type of plan seemed to work to the advantage of young, salaried employees (which was the majority of employees at the time of plan formation).

Just two of the fifteen plans represented were part of multiemployer arrangements; the other plans were single employer plans. The two multiemployer plans resulted from union negotiations. One firm made monthly contributions on a "cents per hour basis" to various union plans, including retirement plans for Operating Engineers, Iron Workers, Teamsters, and Millwrights.

Plans used three major types of eligibility requirements: employee type requirements, minimum age requirements, and minimum service requirements. Firms with one pension plan--7 of 11 firms--allowed all employees to participate in the plan (with the exception of one firm, which permitted all employees to participate except commissioned salespersons). Those firms with two plans--the remaining four firms--had one plan for salaried and/or non-union employees and a separate plan for hourly and/or union workers.

Most of the firms interviewed had age and service requirements. Seven of thirteen plans (54 percent) had both age and service requirements. Four plans (31 percent) had only a service requirement. No plans had a minimum age requirement by itself. Two plans had no minimum age or service requirement. Similar to the SBANE survey findings, the most common minimum age requirement was 25 years of age; the most common service requirement was one year of employment (usually defined by the 1,000 hours rule).

Most of the plans provided full vesting after ten years of service. Nine of thirteen plans (69 percent) fully vested employees at ten years (i.e., 100 percent vesting after 10 years); three other plans had 100 percent vesting after 15 years and one plan had a graded vesting which provided full vesting after eight years of service. There was considerable variety in the starting period for vesting, including: 10 percent after one year, 12.5 percent after one year, 20 percent after two years, 25 percent after five years; 33 percent after five years, and 50 percent after five years.

Few of the interviewees knew if their plans were integrated with social security--just three interviewees responded affirmatively to this question.

None of the firms interviewed had supplemental plans, such as ESOPs, TRASOPs, savings or thrift plans, or 401Ks.[1] Most were unaware of the availability of these supplemental plans.

Most of the defined benefit plans had provisions for early retirement. Some had both an age and service requirement for early retirement (e.g., 60 years of age and 15 years of service, 55 years of age and 15 years of service) and others had only an age requirement (e.g., 62 years of age).

Five of twelve plans (41 percent) had participant loan/withdrawal provisions. Most firms paid benefits directly from the pension fund (eight of nine plans for which information was available); three plans had an option of payment directly from the fund or through the purchase of annuities. Finally, similar to SBANE findings, most of the firms interviewed invested funds in stocks, bonds and cash accounts.

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[1] Section 401(K) of the Internal Revenue Code provides for a qualified cash or deferred arrangement in a profit sharing or stock bonus plan under which: (1) a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee or to the employee directly in cash; (2) amounts held by the trust may not be distributed to participants or other beneficiaries earlier than upon retirement, death, disability, separation from service, hardship, or the attainment of age 59-1/2, and (3) an employee's right to his accrued benefit derived from employer contributions made to the trust are nonforfeitable.

C. HEALTH BENEFITS

1. Findings from National Aggregate Data Analysis

Limited data are available on the specific provisions of small health plans. We used the ICF Health Plan Data Base to analyze the characteristics of health benefit plans. This data base is a representative sample of over 2,100 employer sponsored health plans. It is composed of data provided in both the 1977/1978 Battelle Survey of Employers and the 1977 BLS Survey of Health Plans. The Battelle data on employers with less than 26 employees were included in the ICF data file because they are the most recent publicly available data on health coverage for small employers. However, because the Battelle data have an unacceptably low rate of response among larger employers, ICF obtained data on larger employer-sponsored health plans from the 1977 Bureau of Labor Statistics Health Plan Survey. This BLS survey provides data on a representative group of plans with 25 or more participants. These merged data from the Battelle and BLS surveys, called the ICF Health Plan Data Base, contain the most extensive and recent data publicly available which is representative of all employer health plans.

We first examined differences in the types of health coverage offered by small and large firms. As shown in Exhibit III-14, workers covered by health plans in small firms are less likely to have family coverage than workers in larger firms. The lower rates of family coverage may be due to the fact that fewer of these workers are married or have families. However, one reason for the lower rates of family coverage is that individual coverage is less expensive than family coverage.

EXHIBIT III-14

DISTRIBUTION OF WORKERS BY TYPE OF HEALTH PLAN COVERAGE AND FIRM SIZE, 1982

	Firm Size		
	1-25	26-100	101 Or More
Family Coverage	53%	60%	62%
Individual Coverage	47	40	38
TOTAL	100%	100%	100%

SOURCE: ICF Health Plan Data Base.

Exhibit III-15 shows that small plans are more likely to require employee contributions than large plans, although the plans of firms with 1-25 employees are less likely to require employee contributions than the plans of employers with 26-100 employees. Again, it is likely that the small health plans require contributions as a way to reduce the costs of the health plan. In recent years, an increasing number of firms have instituted employee contribution requirements as a method of controlling the costs of health plans.

EXHIBIT III-15

PREVALENCE OF CONTRIBUTORY HEALTH PLANS, BY FIRM SIZE, 1982

	Firm Size		
	1-25	26-100	101 Or More
Percentage of Workers in Plans Which Require Contributions for:			
Family Coverage	55%	70%	40%
Individual Coverage	30%	25%	24%

SOURCE: ICF Health Plan Data Base.

We also used the ICF Health Plan Data Base to examine the types of benefits offered by the health plans of small firms. Exhibit III-16 shows that, in general, small firms have less generous coverage than large firms. This is most striking in the areas of dental insurance and maternity benefits.

EXHIBIT III-16

PERCENT OF WORKERS WITH COVERAGE FOR DIFFERENT TYPES OF BENEFITS, BY FIRM SIZE, 1982

	Firm Size		
Type of Benefits	1-25	26-100	101 Or More
Hospital/Surgical	100%	100%	100%
Major Medical	88%	93%	90%
Dental	15%	13%	50%
Outpatient Drug	89%	90%	95%
Maternity	77%	74%	94%
Outpatient Mental Health	76%	84%	88%

SOURCE: ICF Health Plan Data Base.

We also used the ICF Health Plan Data Base to examine the extent of cost-sharing through deductibles and coinsurance provisions. Exhibit III-17 shows that medium size firms (26-100 employees) are most likely to have deductibles and coinsurance provisions. About 85 percent of workers in both the smallest and largest size firms have deductibles. Although almost 80 percent of small plans have coinsurance provisions, small plans are the least likely to have these provisions.

EXHIBIT III-17

PERCENTAGE OF WORKERS COVERED BY PLANS WITH DEDUCTIBLES AND COINSURANCE, BY FIRM SIZE, 1982

	Firm Size		
	1-25	26-100	101 Or More
Deductible	85%	92%	84%
Coinsurance	78%	91%	85%

SOURCE: ICF Health Plan Data Base.

2. Findings from Regional Surveys

Both the SBANE and SMC Surveys asked questions about the characteristics of the health benefits of small firms. Exhibit III-18 shows that small firms were most likely to use Blue Cross/Blue Shield Insurance as an insurance carrier. However, there was considerable disparity between the SBANE and SMC results--half of the SBANE firms interviewed used Blue Cross/Blue Shield, while 80 percent of the small firms in the SMC sample offered this type of coverage. Slightly less than half of the SBANE firms (46 percent) offered coverage sponsored by a different insurance company than Blue Cross/Blue Shield; compared to 18 percent of the firms in the SMC survey. Health Maintenance Organization (HMO) coverage was provided in 10 percent of the SBANE firms and 15 percent of the SMC firms; only a small percentage of firms used self-insurance.

Exhibit III-19 shows that 14 percent of the firms in the SBANE survey provided two types of health plans to their employees. SBANE firms that had only one plan were as likely to have other insurance company sponsored plans as they were to have Blue Cross/Blue Shield. About two-thirds of the plan combinations involved an HMO option with another insurance sponsored plan--overall 10 percent of the firms offered health insurance with the option of HMO coverage. A distribution of type of health insurance coverage by firm size revealed no discernible pattern among firms with less than 500 employees. It appears, as expected, that firms under 50 employees were less likely to offer HMO or self-insurance than firms over 50 employees.

Two possible mechanisms for controlling health care costs are higher deductibles and co-insurance. Deductibles are an initial amount usually paid by the individual before the insurance begins to pay for medical expenses.

EXHIBIT III-18

TYPE OF INSURANCE, SBANE AND SMC SURVEYS, 1982

Type of Carrier	SBANE Number of Plans	SBANE Percent of All Firms Using Plan	SMC Number of Plans	SMC Percent of All Firms Using Plan
Blue Cross/Blue Shield	88	(50%)	151	(80%)
Other Insurance Co.	80	(46%)	35	(18%)
Self-Insurance	18	(7%)	3	(2%)
Health Maintenance Organization (HMO)	18	(10%)	28	(15%)
Total Plans	204	--	217	--
Total Firms	174	--	190	--

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

EXHIBIT III-19

TYPES OF PLAN COMBINATIONS BY CARRIER, SBANE DATA

	Number	Percent
Firms with One Plan		
Blue Cross/Blue Shield	68	39%
Other Insurance Company	68	39%
Self Insured	12	7%
HMO	1	1%
Subtotal	149	86%
Firms with Two Plans		
BC/BS and HMO	12	7%
BC/BS and Insurance Company	8	5%
Other Insurance and HMO	4	2%
Self Insurance and HMO	1	1%
Subtotal	25	14%
Total Firms	174	100%

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

Co-insurance is a feature by which the insurance company and the individual share the cost of medical expenses incurred during a given year. Exhibit III-20 shows that 85 percent of the firms had a deductible and about two-thirds of the firms (64 percent) had a deductible of $100. Fifteen percent of the sample had no deductible, while just five percent of these firms had deductible of over $100. Fifty-three percent of the firms applied the deductible to all medical bills, while 47 percent applied the deductible to out-of-hospital charges only.

Exhibit III-20 also shows that about 80 percent of the firms surveyed by SBANE had some form of co-insurance. Seventy-eight percent of the firms had plans in which the insurance paid 80 percent of medical expenses after the deductible and the employee paid the remaining 20 percent. In about one-fifth of the firms, the insurance paid 100 percent of the expenses after the deductible.

Finally, Exhibit III-21 shows that a very high proportion (96 percent) of the firms in the SMC survey covered the employee's dependents for both hospitalization and surgery, and major medical expense.

3. Findings from On-Site Case Studies and Interviews

Telephone discussions with fifteen small firms and on-site case studies of three firms provided further information on the characteristics of health plans in small firms. Exhibit C-2, in Appendix C, summarizes key factors of plans in the firms interviewed by telephone.

We found patterns of coverage similar to those found in the SBANE Survey. For example:

- About half of the firms offered two or more health plans to their employees.

EXHIBIT III-20

TYPES OF DEDUCTIBLE AND CO-INSURANCE PROVISIONS, SBANE SURVEY (1982)

	# of Firms	% of Firms
Amount of Deductible a/		
No Deductible	25	15%
$25	10	6%
$50	16	10%
$100	101	64%
$150	1	1%
$200	2	1%
Greater than $200	4	3%
TOTAL	159	100%
Deductible Applies to: b/		
All Medical Bills	66	53%
Out of Hospital Expenses Only	58	47%
TOTAL	124	100%
Coinsurance (Percentage Paid by Insurance After Deductible) c/		
100%	29	21%
90%	2	1%
80%	110	78%
TOTAL	141	100%

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a/ Information was not available for 15 firms.

b/ Information was not available for 50 firms.

c/ Information was not available for 33 firms.

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

EXHIBIT III-21

COVERAGE OF EMPLOYEE'S DEPENDENTS, SMC SURVEY (1982)

Type of Plan Coverage	Dependents Covered	Dependents Not Covered	Total
Hospitalization and Surgery	218 (96%)	8 (4%)	226
Major Medical	212 (96%)	9 (4%)	221

SOURCE: The Smaller Manufacturer's Council of Pittsburgh's (SMC) 1982 Wage and Fringe Benefit Survey.

- Two of the seven firms with multiple plans offered separate plans to their hourly, union employees. The other five firms with multiple plans offered their employees a choice--between an insurance carrier (e.g., Blue Cross/Blue Shield or other insurance company) or Health Maintenance Organization (HMO) coverage.
- As firm size increased (among the fifteen firms interviewed), they were more likely to offer an optional health plan--generally HMO coverage.
- About half of the firms interviewed (eight or fifteen) offered Blue Cross/Blue Shield coverage; seven offered other types of insurance company coverage; six offered HMO coverage; and two firms were self-insured.

The general reason that firms gave for selecting a particular plan was price--e.g., management felt that the insurer offered the set of benefits desired for the lowest cost. Many of the firms interviewed indicated that they had recently either changed carriers or reduced the level of coverage (i.e., from high-option coverage to regular coverage). Most of these changes in coverage resulted from a need to hold down health care costs. Other reasons given for the selection of particular types of plans included: ease of setting up the plan; convenience in on-going administration and claims reimbursement; desire to cover a particular contingency, such as catastrophic illness; government requirements for provision of optional health care plans (HMOs); and union negotiations and employee input.

Two firms were self-insured, under which the firm paid directly for medical bills of employees and paid monthly insurance premiums to cover employee claims in excess of a set amount (e.g., above $10,000). The reasons given for the establishment of a self-insured plan included: cost control and savings; flexibility in writing the plans; and ease of administration.

All interviewed firms offered major medical coverage and most (80 percent) offered coverage for physician services. Except for two firms that covered specific types of employees by particular plans, firms made their plans open to all employees that met certain minimum service requirements. Only one of the fifteen firms had no minimum service or hours requirement. Most firms had a minimum service requirement of 60 to 90 days, with the longest period being 6 months. About half of the firms also had a minimum hours requirement--generally requiring that an employee either work half-time (20 hours/week) or full-time (40 hours/week). Finally, most firms (80 percent) had some form of deductible, which firms used to hold down the cost of claims. The usual deductible was $100 per year for individuals and $200 per year for families.

IV. ADMINISTRATION AND COSTS OF SMALL PENSION AND HEALTH PLANS

A. OVERVIEW

This section presents information on the administrative practices and costs of pension and health benefits in small firms. We present analyses based on aggregate and regional data as well as findings from interviews with small employers. In addition, this section focuses on some of the problems faced by small employers with government regulations.

In analyses of aggregate data, we found that per capita pension costs are substantially higher for small establishments than large establishments. For example, per capita costs decline from $1,080 for establishments with 1-10 workers to $574 for establishments with 500-999 workers. In addition, per capita pension administration costs, which are highest for very small firms (1-10 employees), decrease as firm size increases. Other findings that emerged from our analyses of national, aggregate data on retirement plans included:

- Cost differences in pension plans are due to several factors, including: (1) administrative costs, (2) benefit generosity, and (3) wage levels.
- On the basis of discussions with plan administrators and actuaries, minimum on-going annual administrative costs are typically $400 for a defined contribution plan and $600 for a defined benefit plan.
- Per capita administrative costs for defined benefit plans exceed those for defined contribution plans regardless of firm size.

Analysis of aggregate data on health benefits indicated that total per capita costs for individual health care coverage are highest for firms under 50 employees--$41 in monthly premiums. However, per capita costs for family coverage are highest for firms with 100 or more employees--$101 in monthly premiums--and lowest for firms with 50-99 employees. We also found from our aggregate analyses that large employers (over 100 employees) pay the highest percentage of health care premiums--95 percent of premiums for individual coverage and 91 percent for family coverage. Small firms, in the 50-99 employee range, paid the lowest share of premiums--68 percent for individual coverage and 51 percent for family coverage. Finally, across all firm size groupings, employers pay a higher percentage of premiums for individual coverage than family coverage.

From our analyses of regional data and interviews with small employers and pension consultants we also found:

- SBANE data indicated that about half of the small firms administer their plans themselves, about one-third use outside plan administrators and the remainder relied on insurance companies.
- SBANE evidence indicated that, on average, small firms (under 500 employees) spent about eight percent of their payroll on benefits.
- In setting up pension plans, most small employers utilized expert pension advisors, such as an actuary or an attorney. Depending upon the size of the firm and the type of plan selected, start-up costs were estimated at between $2-5,000 for small plans.
- Most small firms stated that they did not feel particularly burdened by government regulation at the time of start-up because they utilized expert pension services. However, regulation clearly affected the initial decision to form a plan and the types of plan selected.
- According to pension consultants and small employers, on-going administrative costs for small firms (under 100) are an estimated $500-1,500 per year--depending upon the type of plan and number of participants.

- Small employers and pension consultants indicated several areas of regulation and reporting requirements that are burdensome--including parts of the Form 5500, "controlled group requirements", percentage coverage requirements, some regulations under Multiemployer Pension Plan Amendment Act (MPPAA), and "merger and spinoff rules".

- Many small employers observed that it was not so much the regulations that were a burden, but rather the constant changes in laws and regulations--which often imposed substantial costs on the firms when they made plan amendments.

B. PENSION BENEFITS

1. Findings from National Aggregate Data Analysis

We used data from the 1977 Bureau of Labor Statistics Employer Expenditures for Compensation (EEC) survey to analyze the differences in per capita pension costs by establishment size. Exhibit IV-1 shows that costs, on a per worker basis, are substantially higher for small establishments than for larger establishments. The exhibit also shows that the per worker costs decline from $1,080 for establishments with 1-10 workers to $574 for establishments with 500-999 workers. Establishments with 1,000 or more workers had higher costs than all but the smallest establishments.

These cost differences are due to a number of factors: (1) administrative costs, which are higher on a per capita basis for small firms than large firms; (2) benefit levels, which are generally more generous for large establishments than smaller ones--in part because of supplemental plans in large firms; and (3) wage levels, which are generally higher in large establishments.

We examined closely the administrative costs of small pension plans. This is difficult, because most firms do not generally report their actual administrative costs. For example, many firms do not report the costs of

EXHIBIT IV-1

PER WORKER PENSION COSTS, BY ESTABLISHMENT SIZE, 1977

Establishment Size	Per Worker Pension Costs in 1977
Less than 10	$1,080
10-25	813
26-49	626
50-99	641
100-499	580
500-999	574
1,000-2,499	646
2,500+	737
	$731

SOURCE: 1977 Expenditures for Employee Compensation (EEC) Survey, Bureau of Labor Statistics.

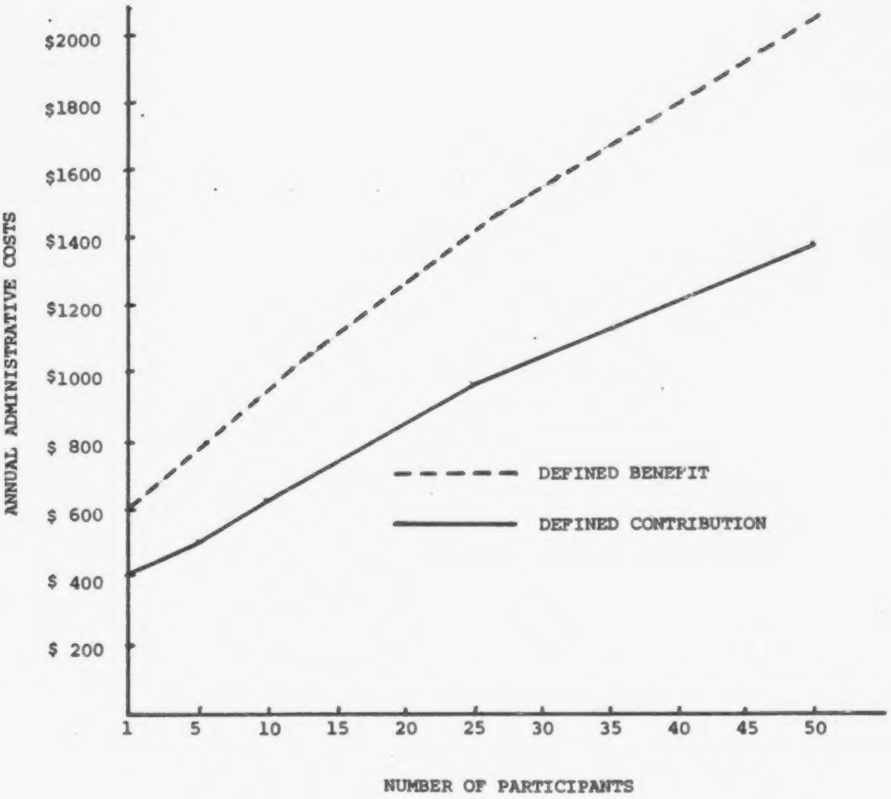
their plans on their Form 5500 because they provide their own administrative services. To estimate the actual costs of plan administration, we talked to a number of plan administrators and actuaries. From these interviews, we were able to develop a schedule of typical costs for plan administration services. These administrative costs are shown in Exhibits IV-2 and IV-3.

Exhibit IV-2 shows that there is, as expected, a minimum annual cost to administer a plan. This exhibit shows that this minimum cost is typically $400 for a defined contribution plan and $600 for a defined benefit plan. Exhibit IV-2 shows that this cost increases at approximately the same rate for both defined benefit and defined contribution plans as the number of plan participants increases.

Exhibit IV-3 shows these typical administrative costs on a per worker basis. It shows that the per capita costs drop quickly for firms with less than 50 participants. They also show that on a per capita basis, the costs for a defined benefit plan always exceed those for a defined contribution plan.

EXHIBIT IV-2

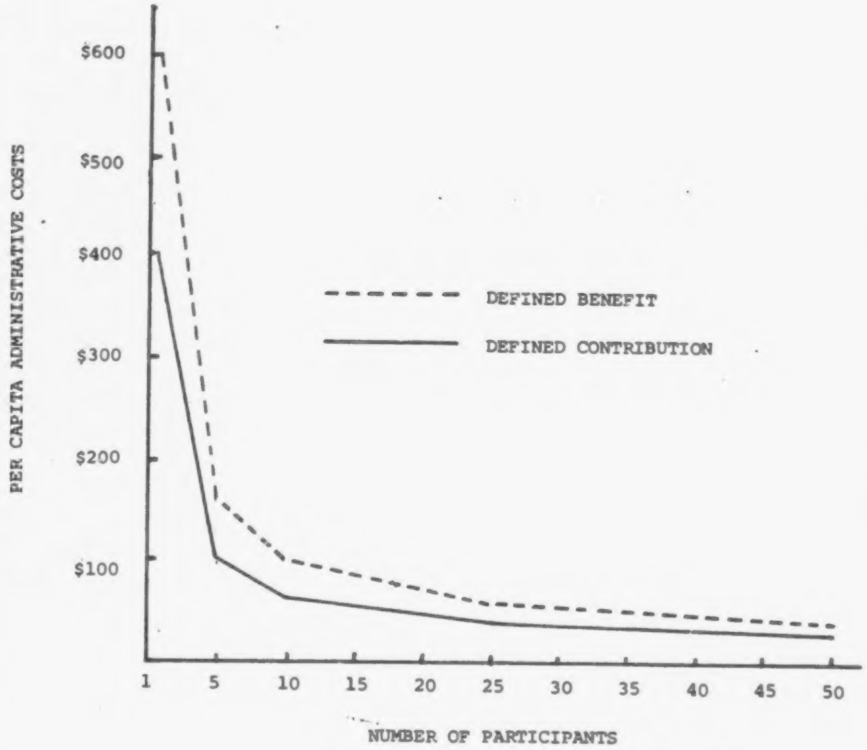
TYPICAL ON-GOING ADMINISTRATIVE COSTS FOR DEFINED BENEFIT AND DEFINED CONTRIBUTION PLANS, 1983



SOURCE: ICF estimates.

EXHIBIT IV-3

TYPICAL PER CAPITA ADMINISTRATIVE COSTS, 1983



SOURCE: ICF estimates.

2. Findings from Regional Surveys

The SBANE survey provides evidence on the nature of on-going administration and costs of pension plans in small firms. We first used the SBANE data to examine the way in which plans were administered. Exhibit IV-4 shows that about half of the small firms in the SBANE survey administered the plan themselves. One-third of the firms used an outside plan administrator and 14 percent relied upon an insurance company.

Firms with profit sharing plans were asked how the profit sharing contribution was made. Of the 55 firms responding to this question, 85 percent reported that the contribution was determined by management or the board of directors and 15 percent reported that the contribution was set by formula. Hence, firms with profit sharing plans appear to have left themselves considerable flexibility in setting contribution levels. This ties in with one of the major motivating factors for selecting a profit sharing plan--flexibility on the part of the firm to make contributions to the fund.

The only cost data on pension plans from the SBANE data base concerns the percent of the payroll spent on retirement benefits. On average, firms spent about eight percent of their payroll on pension benefits. A breakdown of the percent of payroll spent on retirement benefits, presented in Exhibit IV-5, shows that no firm in the SBANE survey spent more than 15 percent of payroll on pension benefits. It also shows that there was a fairly even distribution of firms across the 1-15 percent of payroll range. A further breakdown of the percent of payroll by firm size yielded no significant pattern as firm size increases or decreases.

EXHIBIT IV-4

ADMINISTRATION OF PENSION PLANS, SBANE SURVEY, 1982

Plan Administration by:	Number	Percent
Company	47	52%
Independent Administration	32	34%
Insurance Company	13	14%
TOTAL	92	100%

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

EXHIBIT IV-5

PERCENT OF PAYROLL SPENT ON PENSION BENEFITS, SBANE SURVEY, 1982

Percent of Payroll	Number	Percent
1-3 Percent	14	23%
4-6 Percent	16	27%
7-9 Percent	9	15%
10-12 Percent	8	13%
12-15 Percent	13	22%
TOTAL	60	100%

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

3. Findings from On-Site Case Studies and Telephone Interviews

Discussions with small firms during on-site case studies and telephone interviews provided extensive detail about administrative costs and factors affecting costs. These findings are presented below in two sections: (1) start-up costs; and (2) on-going administration and costs.

a. Start-Up Costs

The case studies of three small firms and discussions with pension plan consultants and actuaries yielded detailed information about plan start-up costs.

Administrative Activities and Costs

As was previously discussed, the impetus for plan formation in small firms often comes from a period of sustained profitability. At a point when a firm becomes profitable, the management/owner-operator becomes concerned about corporate taxes. When this occurs, one option that a firm will generally investigate is setting up a pension plan. During our discussions with actuarial firms, one actuary identified the following steps that many firms went through in setting up a plan:

- after reaching a point of sufficient profitability, the firm will recognize that a tax problem exists (sometimes as a result of professional financial advice);
- the firm will then seek professional financial advice (e.g. from a financial planner, accountant, insurance agent or attorney);
- discussions will be conducted between the management of the firm (usually the owner-operator) and the financial advisor to identify the type of plan that is desired;
- the financial advisor will then make actuarial valuations for the major types of pension plans under consideration and review these with the firm;

- the firm will make a choice of a plan and the details of the plan will be refined and formalized;
- the financial advisor will then write the plan document;
- the plan will be reviewed and approved by the firm;
- the financial advisor will initiate a formal valuation and determine the company's initial contribution to the fund; and
- the plan will be filed with and approved by the Internal Revenue Service.

The case studies provide two detailed examples of the process of plan formation. Firm A, a small manufacturer of steel wire, closely followed the major steps detailed above in plan formation. This firm initiated a defined benefit plan at the time of company incorporation in 1978, four years after the firm was established. At the time of plan formation, the firm had been profitable for several years. In response to this profitability, the owner-operator commissioned an outside financial planning firm to do a study on all aspects of the company's operations. One recommendation that emerged from this study was that the firm establish a pension plan. The financial planning firm reviewed the major types of plan options with the owner-operator. On the recommendation of the financial advisor, the owner-operator selected a defined benefit plan. This plan provided the older, more highly compensated owner-operator with a more substantial retirement benefit than other types of available plans.

Once the type of plan was selected, the financial planning advisor developed and proposed a plan document, which incorporated the major features decided by the owner-operator. Then, the company's attorney reviewed the plan document and Firm A adopted the plan. The financial advisor made a formal actuarial valuation and determination of initial contribution. The plan was filed with the Internal Revenue Service. The owner-operator estimated that plan formation was completed over a 6-8 month period.

In addition to the time spent by the owner-operator of Firm A, the major costs involved in plan formation included fees for financial planning, legal, and actuarial services. Within the firm, the owner-operator was the only employee directly involved in setting up the plan. Major activities that the owner-operator became involved in included: review of the financial management study, discussions outlining major aspects of the plan, review of the financial planner's recommendations, and review of the plan document and initial valuation. The owner-operator estimated that he spent only about eight hours during this process.

Outside of the firm, the owner-operator used financial planning, legal, and actuarial services. The initial management study, conducted by a financial planning firm in 1978, cost $700. This study also included recommendations for many other aspects of his business. Costs resulting from the review of the plan document by the company's attorney were estimated at several hundred dollars. The initial actuarial valuation and determination of firm contribution (done by the financial planning firm) cost $350. Hence, outside assistance in setting up the plan was in the $1,000-$1,500 range (in 1978).

The owner-operator of Firm A noted that the costs of setting up a plan were a higher percentage of annual fund contributions for small firms compared to large firms. In addition, he noted that larger firms were more likely than small firms to have staff with expertise to assist in the formation of a plan. The owner-operator expressed concern that small firms, like his own, generally needed to purchase "high priced advice" to establish a plan.

Firm B, a moving and rigging firm established in the 1870's, established its plan under a different set of conditions than Firm A, but went through a similar process. Prior to 1976, the company's employees were covered by a variety of pension plans, including the Teamster's, Operating Engineers, Iron Workers, and Millwrights. During the next five years, several union employees moved into management positions. In 1981, business conditions caused these employees to withdraw from the unions (primarily the Teamster's) and their respective pension plans.

Consequently, in 1981 Firm B established a profit sharing plan for its nonunion, salaried employees. The union employees at the firm continued to be part of various multiemployer plans. At the time of plan formation, the firm's management wanted to cover the non-union employees with a pension plan. Another important consideration in selecting a plan was that the firm not be required to make contributions during periods of low profitability. Unlike many firms at the time of plan formation, Firm B had experienced low profitability in the years preceding the establishment of the plan.

In setting up the plan, the firm president and two other management employees (who eventually became plan trustees) initially met with a pension attorney from the company's law firm. Six to eight meetings were held between the pension attorney and the firm's representatives, during which various plan options were discussed. Because the firm wanted to avoid making payments into the fund during periods of low profitability, a profit sharing plan was recommended by the attorney.

The details of the plan document were drawn up by the pension attorney, in consultation with the firm's management. The lawyer also prepared projections of the plan's costs. After a period of 6-8 months, the plan was adopted by the firm and filed with the Internal Revenue Service. Finally, a local bank set up an account for the plan and was contracted with to provide on-going administration of the plan.

Within Firm B, four employees--the president, two management employees and a payroll officer--were involved in setting up the plan. The president and two management employees attended 6-8 meetings with the pension attorney and reviewed plan recommendations (2-3 hours per meeting). In addition, a payroll officer provided necessary statistical information to the lawyer for cost projections (3-5 hours). External to the firm, a pension attorney was extensively involved in setting up the plan. It is estimated that this attorney provided between 75 and 100 hours of consultation, at a cost under $10,000.

Problems in Plan Formation

In the view of the president of Firm B, the most burdensome aspect of setting up the plan involved understanding the many complex options available. Similar to Firm A, the president of Firm B noted that it was necessary for a small firm to seek costly expert advice during plan formation.

During telephone interviews with eight other firms with pension plans, interviewees were asked about the types of barriers or obstacles that their firm faced in setting up a pension plan. Most respondents said that they had not faced major barriers in setting up their plan because they consulted experts to guide them through the process.

Most firms indicated that government regulation had not posed a major problem to them in setting up the plan. For example, several firms commented that they were only given options which met government regulations.

However, several small firms which did not currently offer pension benefits, indicated that government regulation had an impact on their decision not to offer benefits, although firm profitability was the most important consideration for them. For example, one interviewee stated that "ERISA was a problem, but not a determining factor". Another commented that ERISA had made the laws governing pensions fairly complex and that he was less willing to establish a plan because of the required paperwork. A third interviewee said that he was aware of the strong regulation of pensions, but that this did not directly affect his decision not to offer benefits. He added that he did not clearly understand these regulations and in future decisions about covering employees this factor might keep him "on the fence".

While government regulation does not appear to pose a major problem or obstacle to the formation of plans in small firms, it can affect the decision to form a plan, the type of plan selected, and the cost of establishing a plan. For example, the following types of regulations affected the decision of one firm to establish a plan: (1) tax benefits, which allowed the firm to shelter some of its profits; and (2) bankruptcy rules, which provided that employees receive certain benefits set aside in the plan before other creditors if bankruptcy should be declared.

Finally, a representative of an actuarial firm that sets up and administers plans for small firms, identified three areas of regulation which affected choices made during plan formation. First, and most important, were tax regulations: most clients were interested in establishing a plan that gave them the greatest tax shelter. Second, the Pension Benefit Guaranty Corporation's (PBGC) regulations relating to the 30 percent of net worth liability that could be imposed in the case of plan termination often affected the firm's choice of plans. Third, ERISA regulations were sometimes a factor, particularly when clients asked for less generous vesting schedules or stricter participation standards than required by ERISA. In cases such as this, it was necessary to notify the client of the restrictions. Finally, for very small plans (under 20 employees), particularly those established by doctors and other small professional partnerships, Section 415 of the Internal Revenue Code--which limits pension benefits--was a major concern. This problem has become an even greater concern since the passage of Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) which further restricts these benefit limits and adds "top-heavy plan rules".[1]

b. On-Going Administration and Costs

On-going administration of pension plans includes such tasks as decisions about investment of plan funds, determination of annual contributions to the fund, processing of loans/withdrawals from the plan, compilation of statistical data (e.g., payroll data), filing of reports (e.g., Form 5500) and forms (e.g., W-2 forms), and making deposits into the fund. Small firms approached the administration of plans in several different ways depending upon the particular expertise within the firm, type of pension plan, and size of the fund. Some firms (such as Firm C), both administer the plan and manage plan assets. Other firms (such as Firm B), delegate responsibility for plan administration and asset management to other firms that specialize in plan administration, such as a local bank, insurance company or actuarial firm.

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[1] For specific regulations of TEFRA relating to pension plans see: Commercial Clearing House, Inc., Tax Equity and Fiscal Responsibility Act of 1982: Law and Explanation, (Chicago, 1982).

And some firms (such as Firm A), contracted with a consulting firm to do some of the more difficult aspects of plan administration, but still retained an active role in other aspects of administration and investment.

Internal Administration

The first model of plan administration--plan administration and asset management done by the firm--was found in three of the eight firms interviewed by telephone and in Firm C of the case studies. Firm C provided a detailed example of this administrative model.

Within Firm C, three employees were primarily responsible for administration of the plan and investment of plan assets: the president, a plan administrator, and a secretary. In addition, this firm used a small business microcomputer to assist in the compilation of statistical data. This firm had a profit sharing plan, which generally entailed somewhat less complex and time-consuming administration than other types of plans. The president made most decisions with regard to the investment of funds, the annual contribution to the fund, and loan/withdrawals from the plan. It was estimated that, on average, the president spent about 6-8 hours per year on these tasks. The plan administrator, with assistance from a microcomputer programmed with a spread sheet type software, computed the annual allocation (including contributions, forfeitures, and interest), compiled data for and completed the Form 5500, made deposits to the fund, processed loans and withdrawals, and completed the W-2 forms (as needed) for employees. The most time-consuming of these tasks was making deposits to the fund--about six hours per month--and the activities involved in the completion of the Form 5500--an estimated 20 hours per year. Several hours per year were spent on processing loans/withdrawals, and about seven hours per year were spent on filling out any needed W-2 forms and detailing pension allocations for each employee. During these tasks, the plan administrator was assisted by a secretary who spent about eight hours per year on pension-related tasks.

External to the firm, the plan administrator occasionally conferred with the firm's attorney and/or accountant about administrative problems and special circumstances, such as withdrawals, loans, enrollment of new employees and changes in regulations. He estimated that 6-8 contacts were made annually, at a cost of about $200 per year.

A major problem area identified by the plan administrator under this administrative model was the investment of plan funds. Firm C, with approximately 20 employees, was too small to have anyone within the firm providing well-informed investment advice and the size of the pension fund was too small to justify contracting for outside investment expertise. As a result, Firm C's pension funds remained relatively static. The firm felt that because of this, investment opportunities were missed.

External Administration

A second administrative model--in which the firm delegates responsibility for plan administration and investment of funds to another firm--was found in Firm B (a rigging and moving firm) and in two of the eight firms interviewed by telephone. Firm B provided considerable detail on this type of plan management.

By choice, Firm B did not take an active role in the plan administration or investment decisions. It delegated nearly all of these tasks to a plan administrator--which was a local bank. Within Firm C, the president and two other plan trustees were occasionally involved in the approval of investment decisions by the independent plan administrator. Several hours a year, the president and plan trustees met with a representative of the local bank to review recommendations for fund investments. The firm management preferred third-party handling of investments, as well as the relatively conservative (risk-free) investment choices made by the plan administrator, for two reasons: (1) the management did not have the time or expertise to make good investment decisions, and (2) the management wanted to avoid criticism and controversy on the part of participating employees that might arise from poor (or even good) investment choices.

In terms of on-going plan administration, Firm B provided the independent administrator with necessary information for making the profit sharing distribution and completing reporting requirements. For example, payroll data (W-2 forms) were provided to the administrator as well as statistical data for the Form 5500. Overall, it was estimated that the firm's management spent no more than 10 hours per year on pension plan administration and investment decisions.

Firm B relied extensively upon a local bank to administer the plan and make investment recommendations. As plan administrator, the bank has been delegated nearly all on-going administrative tasks, including: filing of the Form 5500, handling deposits to the account, and maintaining statistical data. Because there has been only one profit sharing distribution to the fund and no one is fully vested, plan administration has been relatively uncomplicated. For services rendered, the local bank charges a half-percent per year investment fee.

In addition, the firm has occasionally referred any pension-related problems to the firm's attorney. To date, there has been little need to consult with the firm's attorney--on average not more than two hours a year. Under this administrative model, the firm identified no major problems.

Shared Administration

A third administrative model--sharing of on-going administration and investment decisions between the firm and an independent administrator--was found in three of eight firms interviewed by telephone and Firm A. Firm A, a small manufacturer of steel wire, illustrates this type of plan administration.

Firm A, which has an integrated defined benefit plan, makes its own investment decisions but contracts with an actuarial firm to do plan administration. Under this administrative arrangement, the owner-operator of the firm performed the following administrative activities: made decisions concerning investment of pension plan assets (in consultation with his stockbroker); coordinated activities of the plan administrator; notified the plan administrator of changes in employee status; and compiled statistical data for the plan administrator for the Form 5500. The owner-operator did not characterize these tasks as particularly time-consuming or burdensome--spending perhaps eight hours per year on administrative tasks, most of which were related to making investment decisions. He has been assisted in these tasks by a secretary.

At a cost of $600 per year, Firm A has contracted with an actuarial firm to do most aspects of on-going plan administration. These tasks include: valuation to determine the required contributions, preparation of employee benefit statements, and compilation of data for and completion of the Form 5500. Use of legal and accounting services to resolve problems has been negligible in recent years.

Problems in Ongoing Administration

The owner-operator of Firm A commented that he had not experienced problems in on-going plan administration in recent years. However, he noted that the cost of on-going administration appears to be a higher percentage of the annual contribution to the pension fund for a small firm compared to a large firm. For example, the $600 that this firm pays in administrative expense is 5.4 percent of the annual contribution made to the pension fund.

Firms interviewed by telephone and on-site identified several effects of regulation on the on-going administration of plans. On the whole, interviewees were supportive of ERISA and other more recent changes to pension laws--feeling that these laws were necessary to protect employees. For example, one employer stated that without the "burden of ERISA", there would be "little protection". However, some firms observed that that passage of ERISA had imposed substantial costs on their firm. Several firms pointed to the costs--primarily attorney's fees--of re-writing plans to conform to ERISA standards. The costs of changing plans to comply with ERISA were estimated at about $1,500. Other firms indicated that they changed to another type of plan in response to ERISA--e.g., one firm went from a defined benefit plan to a profit sharing plan; another firm dropped its defined benefit plan, but retained its profit sharing plan; a third firm terminated its plan and did not establish a successor plan because of costs involved in rewriting the plan.

In-depth discussions during case studies with firms identified several effects of pension plan regulation on business operations and decisions. One unique problem stems from the existence of "controlled group requirements".[1] Because of these requirements, a small firm may face considerable problems in acquiring another firm. These requirements may force a company (with a pension plan) that acquires another company to provide a pension plan to employees of this purchased firm even if the profitability of this acquired firm is not sufficient to sustain such a plan. Potential buyers who do not have a pension plan are at a competitive advantage because they are not required to provide a plan to employees of the acquired firm. In general, the impact of the "controlled group requirement" appears to be greater for small firms than large firms because of the "percent coverage requirement". Under the percentage coverage requirement (sometimes referred to as the Arbitrary Rule), either: (1) 70 percent or more of all employees, exclusive of short service, seasonal and part-time employees, must be covered; or (2) at least 70 percent of the employees, similarly defined, must be eligible for coverage under the plan and at least 80 percent of all eligible employees must actively participate.

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[1] ERISA section 210(d) indicates that all employees of businesses which are under common control shall be treated as employed by a single employer. Thus, if company "A" with a pension for its 20 employees purchases company "B" which has 30 employees and does not provide a pension for the new employees, its pension plan will no longer satisfy IRS participation requirements. The controlled group is company "A" and company "B" and only 40 percent of the employees of the controlled group would be covered. As a result, the plan would lose its tax qualified status since Section 410(b) of the Internal Revenue Code states that 70 percent of all employees who meet minimum age and service requirements must be eligible to participate in the plan for the plan to be a tax qualified plan.

The greater impact on small firms can be seen in the following example: A company with 10,000 employees could purchase a small firm with 10 employees and not be required to provide pension benefits to employees of the small firm. However, a firm with 20 employees could not meet percent coverage requirements if they purchased the same firm (with 10 employees) without including the new employees in their own plan.

Another problem identified during discussions with firms involved regulations governing multiemployer plans--specifically, the Multiemployer Pension Plan Amendment Act (MPPAA). Firm C, a rigging and moving firm, indicated that MPPAA regulations had contributed to the failure of numerous trucking firms and undermined the participation of new firms in multiemployer plans. Two reasons were given. First, the imposition of withdrawal liability, which was legislated by MPPAA, had placed heavy burdens on the owners of established firms and made it very difficult for owners to sell firms. Second, companies that negotiated contracts with unions did so on a "cents per hour" basis for pension (and other types of) benefits. The imposition of other types of additional pension liabilities by regulation (such as by MPPAA) after these agreements had been negotiated made bidding on multi-year contracts difficult.

In-depth interviews with pension experts at two actuarial firms--which both set-up and administer plans for small firms--identified several other impacts of regulation and problems faced by small firms. One actuary indicated that her small business clients experience no major difficulties with on-going administration as a result of regulations since the actuarial firm filled out most forms such as the 5500. However, this actuary felt that the constant changing of laws and regulations that has taken place over the past five to ten years has added significantly to the cost of administering a pension plan. Some problems in the completion of the Form 5500 were also identified:

- Question 15 requires unnecessary detail. Particularly questions relating to the percentage of plan assets and diversity of investments may have meaning for a larger plan but not for a small plan.

- Question 16i and 18c are ambiguous in the case of a plan for which the sponsor pays all administrative expenses outside of the fund. What the employer pays for administration over and above his pension contribution is irrelevant information.

- Question 18a, which requests an explanation of what a trustee is charged, is unclear as to what type of explanation was needed.

- Question 19a requests unnecessary detail on transactions. If a plan abides by regulations relating to loans, having to detail all of the rather trivial transactions involved in loans causes an excessive amount of administration especially for loans that are no longer outstanding. For example, one plan filed a 5500C every three years. Although it had only four lives covered under the plan, numerous loans over that three year period of duration of less than six months merit that records had to be obtained on over 25 loans most of which were no longer outstanding at the time of filing.

- Question 21d is ambiguous. It asks if any contribution has been late under the terms of the plan. A plan may call for a contribution "at the end of the plan year". Second 412 of ERISA gives firms 8½ months after the end of the plan year to make a contribution. A contribution that is in compliance with ERISA may technically be "more than three months past due under the terms of the plan".

In addition to problems with the Form 5500, the actuary indicated that the plan termination Form 5310 is very burdensome on small plans. Supplying a 10 year salary average represents a considerable burden for a plan that is fully funded and for which 10-year cutbacks do not apply.

Finally, the actuary indicated that merger and spin-offs rules unnecessarily create special problems for small plans. There is a necessary cost associated with filings that meet a required regulatory need, but the IRS adds unnecessary costs by specifying in its revenue rulings complicated procedures, especially in the case of spin-offs that do not occur on the plan year anniversary. IRS also requires From 6088 for a professional corporation even if it is has no PBGC liability.

Aside from the inefficiencies of the Form 5500 discussed above, this actuary indicated that major ongoing administrative problems generally related to special situations. The biggest problem has been the constant state of flux of regulations and laws. The adverse administrative impact of numerous changes could be greatly decreased if implementation in existing plans could be delayed for a few years so that numerous changes could be made at the same time. For example, plans could be required to be amended only once every three years to come into compliance with new legislation. At that time, all required changes could be made. In most cases, there would be little or no adverse impact on the intent of the law resulting from this delay in implementation. Fewer plans might terminate and more plans might be formed if sponsors did not fear the cost of constantly changing laws and regulations.

Interviews with a second actuarial firm identified several other effects of regulation and problems faced by small firms in administering plans. An actuary from the second actuarial firm felt that filing requirements are needed and indicated that although the cost per covered employee is much higher for small plans, it is, in fact, in the small plan area that there is the greatest abuse of pension plans. He thought that relaxation of filing requirements might be possible in the case of certain standard simplified plans--such as non-integrated plans, permitting no loans, having a bank or other financial institution as a trustee and having an enrolled actuary do all of the administration. More complicated plans and ones that fund toward retirement at age 55 and in other ways stretch the limits of regulations need to meet more extensive filing requirements.

Although this actuary agreed with the spirit of filing requirements, he felt that certain aspects of reporting and disclosure are carried to a burdensome extreme. The new Form 5500C is more time consuming than the old one and filling it out only every third year is more of a burden than filing the old Form 5500 every year was. In addition to the Form 5500, a plan has to file joint and survivor notices nine months prior to when an employee is eligible for early retirement, suspension of benefit notices after an employee reaches age 65 in certain plans, summary annual reports, summary plan descriptions, summary of material modification notices and PBGC premium reports. He also feels that the Financial Accounting Standard Bureau (FASB) proposal regarding how to expense pension contributions is an excessive burden on pension plans.

The actuary and plan administrator found that one of the biggest problems faced by small firms was that laws and regulations have changed so frequently in recent years--requiring employers to amend their plans almost every year. This doubles or triples the annual administrative cost of maintaining a small plan. In addition, TEFRA limits the benefits to the owner-operator of maintaining a pension plan.

The actuary cited several specific areas of regulation that are unnecessarily burdensome:

- The suspension of benefits notice is unnecessary. Employees already receive a summary plan description and can always come to the plan administrator to review their benefits. Many workers who decide to work past age 65 research the issue thoroughly and find out what the impact will be on their pension benefit independent of receiving the suspension of benefits notice.

- The requirement of providing retirement information nine months prior to the employee's retirement date is unnecessary. Exact figures are provided when the employee retires. Prior to that, the employee receives or can request a benefit statement on an annual basis.
- The requirement of an accountant audit in the case of insured plans or plans trusteed by a bank is useless since there is nothing to audit.
- PBGC requires that plans count as participants non-vested, former employees who have terminated employment but who have not yet incurred a break in service. The actuary estimates that less than one percent of such workers ever return to employment. Keeping track of all these incomplete breaks in service creates an unnecessary record keeping burden.
- IRS requires a plan to obtain approval of a change of funding method even when certain minute details of the valuation are changed. This can unnecessarily cost a plan several hundreds of dollars and create unnecessary work for the IRS.

C. HEALTH BENEFITS

1. Findings from Aggregate Data Analysis

We used the ICF Health Plan Data Base to examine the costs of providing health benefits in different size firms. Exhibit IV-6 shows the total premiums paid by both employers and workers for health plan coverage. This exhibit shows that the total per-capita costs for individual coverage are highest for small firms. It also shows that individual monthly premiums do not differ greatly by firm size. Exhibit IV-6 shows that per-capita premiums for family coverage are highest for firms with 100 or more workers. The exhibit also shows that for both individual and family coverage, per-capita premiums are lowest for firms with 50-99 employees.

We then examined the level of monthly, per capita premiums paid by employers. As with total premiums for individual coverage, small firms pay the highest average premium although firms with 100 or more workers pay an almost equal amount. Exhibit IV-7 also shows that, similar to total premiums, employer premiums for family coverage are highest for large firms.

EXHIBIT IV-6

AVERAGE PER CAPITA MONTHLY HEALTH PREMIUMS, BY FIRM SIZE, 1980

Type of Coverage	Firm Size 1-49	 50-99	 100 Or More	Total
Individual Coverage	$41	$35	$38	$39
Family Coverage	$92	$87	$101	$99
Total	$68	$63	$77	$74

SOURCE: ICF Health Plan Data Base.

EXHIBIT IV-7

AVERAGE EMPLOYER PER CAPITA MONTHLY HEALTH PREMIUMS, BY FIRM SIZE, 1980

Type of Coverage	Firm Size 1-49	 50-99	 100 Or More	Total
Individual Coverage	$36	$24	$36	$36
Family Coverage	$68	$44	$92	$85
Total	$53	$35	$71	$65

SOURCE: ICF Health Plan Data Base.

Much of the differences in employer premiums are due to the relative shares of costs borne by employers and workers. Exhibit IV-8 shows that large employers pay the highest percentage of health care premiums. For example, firms with 50-99 employees pay only 55 percent of total premiums--in part because they pay only slightly more than one-half of the costs of family coverage. Firms with less than 50 workers pay over three-quarters of the total premiums for health coverage. The exhibit also shows that in all firm size groups, employers pay a higher percentage of premiums for individual coverage than family coverage.

EXHIBIT IV-8

AVERAGE PERCENTAGE OF HEALTH PREMIUMS PAID BY EMPLOYERS, BY FIRM SIZE, 1980

Type of Coverage	Firm Size 1-49	 50-99	 100 Or More	Total
Individual Coverage	87%	68%	95%	92%
Family Coverage	73%	51%	91%	87%
Total	77%	55%	92%	88%

SOURCE: ICF Health Plan Data Base.

2. Findings from Regional Surveys

The SBANE data base provides some data on the current costs of health care to small firms. Exhibits IV-9 and IV-10 provide a breakdown of the monthly cost of health insurance coverage overall, and by employee and employer. In over half of the firms (54 percent), single employees were not required to make any contribution toward health insurance costs; 36 percent of the family employees made no contribution. Total monthly costs for health coverage of single employees were most frequently in the \$60-\$79 range (35 percent of the firms) and for family coverage in the \$160-\$199 range (35 percent of the firms). Monthly costs to firms were most likely to be in the \$40-\$59 range for single employees and in the \$80-\$119 range for family employees.

Exhibit IV-11 summarizes available cost data from the SMC data base. This regional data base shows a high percentage of firms paying the entire cost of hospital and surgery (94 percent) and major medical (94 percent) insurance.

EXHIBIT IV-9

MONTHLY CONTRIBUTION OF EMPLOYEES/EMPLOYERS FOR HEALTH INSURANCE (FAMILY EMPLOYEES)

	Monthly Cost of Health Insurance							Total
	$0	$1-39	$40-79	$80-119	$120-159	$160-199	200+	Firms
Employee's (Family) Contribution	47 (36%)	30 (23%)	34 (26%)	17 (13%)	2 (2%)	1 (1%)	--	131 (100%)
Employer's (Family) Contribution	1 (1%)	3 (2%)	28 (21%)	48 (37%)	32 (24%)	12 (9%)	7 (5%)	131 (100%)
Total (Family) Costs	--	--	4 (3%)	30 (22%)	40 (30%)	48 (36%)	13 (10%)	135 (100%)

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a/ Exhibit presents number of firms that fall within each cost interval (e.g., 50 of 134 firms required no contribution by family employees toward health insurance). Percentages figured on basis of each row total number of firms.

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

EXHIBIT IV-10

MONTHLY CONTRIBUTION OF EMPLOYEES/EMPLOYERS FOR HEALTH INSURANCE (SINGLE EMPLOYEES) a/

	Monthly Cost of Health Insurance							Total
	$0	$1-19	$20-39	$40-59	$60-79	$80-99	$100+	Firms
Employee's (Single) Contribution	72 (54%)	39 (29%)	15 (11%)	7 (5%)	1 (1%)	1 (1%)	--	134 (100%)
Employer's (Single) Contribution	3 (2%)	4 (3%)	35 (26%)	55 (41%)	29 (22%)	6 (5%)	2 (1%)	134 (100%)
Total (Single) Costs	--	--	17 (12%)	59 (43%)	48 (35%)	10 (7%)	3 (2%)	137 (100%)

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a/ Exhibit presents number of firms that fall within each cost interval (e.g., 72 of 131 firms require no contribution by single employee toward health insurance).

SOURCE: Small Business Association of New England's (SBANE) 1982 Survey of Fringe Benefits.

EXHIBIT IV-11

COMPANY CONTRIBUTION TOWARD HEALTH CARE COVERAGE, SMC (1982)

Company Contribution (%)	Hospital + Surgery	Major Medical
100%	212 (94%)	211 (94%)
90%	4 (2%)	4 (2%)
85%	3 (1%)	3 (1%)
80%	1 (a/)	1 (a/)
75%	2 (1%)	1 (a/)
66.7%	1 (a/)	1 (a/)
50%	3 (1%)	3 (1%)
TOTAL	226 (100%)	224 (100%)

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a/ Less than 0.5 percent.

SOURCE: The Smaller Manufacturer's Council of Pittsburgh's (SMC) 1982 Wage and Fringe Benefit Survey.

3. Findings from Telephone Discussions and On-Site Studies

Telephone discussions and on-site case studies uncovered considerable concern among employers over the rising costs of health care coverage in recent years. Exhibit IV-12 displays health plan costs for the fifteen firms interviewed by telephone. Average monthly costs for health benefits was about $80 per month for single employees and $194 per month for family employees. Health insurance costs ranged from $56 to $100 per month for coverage of single employees and from $156 to $250 for coverage of family employees.

Firms absorbed most of the monthly costs of health insurance. Just one-tenth of the firms indicated that single employees made a monthly contribution toward health benefits (i.e., in 2 out of 20 plans for which cost data were available). A slightly higher percentage of firm plans--17 percent--required a contribution from employees toward health coverage of their families. Monthly contributions ranged from $10 to $75 per employee.

No discernible pattern with respect to cost of health insurance and firm size emerged from this small sample of firms. However, during other discussions with representatives of small business organizations, considerable concern was expressed over premiums paid by smaller employers. Smaller firms often face a restricted choice of health benefit plans and, because they are unable to pool risk across a large number of employees, face higher costs. In addition, costs of coverage for a small firm may become prohibitively high after a series of large claims.

Costs of plans played a central role in firm's decisions about the type of plan coverage offered to employees. About one-third of the firms interviewed, said they had recently changed their plans. In all cases, changes were made in the insurance carrier in an attempt to control costs.

EXHIBIT IV-12

COST OF HEALTH PLAN COVERAGE FOR SINGLE AND
FAMILY EMPLOYEES, TELEPHONE DISCUSSION WITH FIFTEEN FIRMS

			Coverage of Single Employees			Coverage of Family Employees		
Firm	Size	Type of Insurance	Employee Contribution	Employer Contribution	Total	Employee	Employer	Total
1	4	BC/BS	N/A	N/A	N/A	0	156	$156
2	8	BC/BS	0	90	90	0	188	$188
		Ins. Co.	N/A	N/A	N/A	N/A	N/A	
3	11	Ins. Co.	0	117	117	44	117	$161
4	14	BC/BS	0	N/A	N/A	0	N/A	N/A
5	15	Ins. Co.	0	75	75	0	225	$225
6	22	Ins. Co.	0	90	90	75	N/A	N/A
7	25	BC/BS	10	75	85	25	225	$250
		HMO	0	65	65	0	200	$200
8	25	BC/BS	0	100	100	0	225	$225
		HMO	0	95	95	0	186	$186
9	35	BC/BS	0	N/A	N/A	0	212	$212
10	42	BC/BS	0	84	84	0	212	$212
		HMO	N/A	N/A	N/A	N/A	N/A	N/A
11	47	Self Ins.	0	a/	a/	0	a/	a/
12	53	Ins. Co.	14	70	84	36	180	$216
13	115	Self Ins.	0	75b/	75b/	0	210b/	$210b/
14	125	Ins. Co.	0	66	66	0	178	$178
		HMO (1)	0	67	67	0	180	$180
		HMO (2)	0	62	62	0	166	$166
15	174	BC/BS	0	c/	c/	0	c/	c/
		Ins. Co.	0	56	56	0	164	$164
		HMO	0	61	61	0	169	$169
Average Cost d/			$1.50	$78.00	$79.50	$6.18	$187.62	$194

a/ Firm 11 was self-insured, the cost of self insurance varied based on the number of claims and amount of the claims; the firm also had catastrophic insurance to cover individual claims in excess of $12,000.

b/ Firm 13 was self-insured; costs were estimated for an average month, but actual cost varied based on the number of claims and amount of claims; the firm also paid a monthly premium to cover individual claims in excess of $10,000.

c/ Firm 15 had a cumulative monthly rate of $123 that covered both families and single employees.

d/ Average costs are figured across those firms that have reported employee, employer, and total contributions. Average cost for single employee coverage was figured using 16 firms; average cost for family employees coverage was figured using 17 firms.

SOURCE: JBA/ICF Telephone Interviews with Small Employers, 1983.

For example, one firm recently made a switch (after 8 years) from a private carrier to self-insurance in an attempt to reduce monthly insurance premiums. This firm also capped liability for claims at the cost of $1 million and introduced a deductible for "non-emergency" emergency room visits. Another firm recently shifted from a high coverage plan (costing $298/month) to 120-day comprehensive/major medical wrap-around coverage (costing $212/month). Two of the three case study firms also recently changed carriers because of spiraling costs--both Firms B and C moved from larger carriers to less expensive smaller insurers.

While nearly all employers cited rising monthly insurance premiums as a problem, few offered ready solutions. Several felt that co-insurance and higher deductibles might help control costs. For example, one owner-operator felt that employees should pay part of the cost of health insurance so they would be aware of cost increases and have more of an incentive to keep costs down.

Others looked to lower levels of coverage of employees and capping of claims as methods for controlling costs. Several firms noted that simplified claims processing--in which the employees filled out claims rather than company personnel--effectively held down some of the overhead costs of plans.

V. IMPLICATIONS AND CONCLUSIONS

This study examined the extent of coverage, characteristics, administrative practices and costs of pension and health care plans in small businesses. This chapter discusses the implications of the study's findings.

Pension Benefits

We found that small businesses are significantly less likely to offer pension benefits to their employees than large firms. In addition, firms in each size classification are substantially less likely to offer pension benefits than health care benefits. Several reasons were given for the lower provision of pension benefits in small firms, including:

- lack of sustained profitability;
- start-up costs;
- complexity of plans and the need for costly expert advice; and
- constantly changing regulations that create uncertainty about future costs and benefits of retirement plans.

If pension coverage is to expand in upcoming years, the impetus for this expansion is likely to come from small firms. As the aggregate data analyses showed in Chapter II, nearly all firms with over 500 employees currently offer pension benefits--hence, increased coverage is only likely to come through expansion of benefits in firms with fewer than 500 employees.

Expanded coverage of pension and health care plans, however, will be problematic given the current conditions faced by small firms. For example, this study shows that the impetus for pension plan formation among small firms is generally sustained profitability and the desire of owner-operators to avoid and/or defer tax payments. If this is the case, then it seems unlikely that any new set of regulations--short of regulations mandating the establishment of private pensions in firms--is likely to substantially expand coverage for firms with low profitability.

However, several alternatives may be feasible which would facilitate and encourage formation of plans for employers that are profitable. The most promising alternatives include:

- a reduction in the costs of establishing plans;
- a decrease in the complexity of establishing and maintaining plans;
- the provision of monetary incentives--in the form of tax credits--to cover costs of plan formation; and
- a reduction in the burden and complexity of complying with current and future regulations governing private pensions.

As Chapter IV shows, the costs of plan start-up for small firms is substantial--in the $2,000 to $5,000 range. Per employee costs of setting up retirement plans are substantially higher for small businesses-particularly if more complex defined benefit plans are selected. A reduction in start-up costs or a spreading of these costs over several years would encourage many small firms to set up plans.

One avenue for reducing start-up costs would be the development of more flexible IRS prototype pension plan documents with variable provisions. Many of the small businesses that were interviewed complained that it was necessary to hire expensive, expert assistance to draft plan documents. Currently, the alternatives for small firms are few: either use the IRS prototype plan, which is a standard form allowing for no variation, or seek costly, professional assistance from attorneys, insurance companies, actuarial firms, etc., to develop a plan. What many small firms are looking for is a middle ground--one in which they can use a standard IRS form, but which provides flexibility with respect to provisions of the plan. In essence, what is needed is various IRS approved plan documents--along with detailed guide books--which permit small businesses to choose a plan type, then tailor that plan to the specific needs of their businesses.

Other possible methods for reducing start-up costs for small businesses would be to offer tax credits to cover set-up costs or to enable small firms to spread costs over the first 3 to 5 years of the plan's existence. Currently, businesses fully absorb start-up costs of pension plan formation. This includes both labor overhead costs and expert external assistance. A tax credit--which would allow businesses to defray plan establishment costs against corporate taxes--would provide considerable encouragement to small firms to establish plans.

Another alternative which might prove effective in reducing the burden of start-up costs would allow small businesses to spread costs over the first several years of plan operation. The cost analysis showed that start-up costs were substantial, but on-going maintenance costs of pension plans--which generally range from $500-$1,500 per year--do not seem to pose a significant problem to small businesses. If this is the case, the spreading of costs across several years may effectively reduce cost barriers to setting up plans.

Reduction of costs faced by small businesses in setting up plans may not be sufficient to increase substantially pension benefit coverage. As Chapter IV shows, there is considerable concern among small businesses over the frequent changes in regulations governing pensions. Despite the concern about ever changing regulations, small businesses generally supported regulation and reporting requirements associated with pensions--feeling that it was necessary for the government to monitor plans to protect employees against abuse and to ensure that benefits are available to participants at the time of retirement.

Constantly changing and increasingly complex rules and regulations governing pensions are reported to be excessively burdensome and problematic. These changes are not only costly--some businesses said they had to amend their plans nearly every year at substantial costs--but also create a condition of excessive uncertainty about the future. Some smaller owner-operators were reluctant to set up plans because they were unsure about the impact of future regulatory developments. In fact, about the only thing they could be sure of was that the rules and regulations would soon be changed (if the past was any indication of the future).

It seems unlikely that regulations governing pension plans will not continue to change--e.g., at this time, Congress is again considering another round of changes in pension laws. One solution to this problem, however, might be to give already established plans in small firms a longer period to come into compliance with new regulations. For example, plan sponsors could be given a three (or five) year period to bring their plans into compliance--making it possible for them to make several changes in their plan at one time, rather than continually amending their plan document.

Finally, during interviews with small employers and actuaries we found numerous areas where regulations were particularly burdensome, complex and/or costly for small employers, including:

- "controlled group requirements" (ERISA Section 210(d) - Internal Revenue Code, Section 1563(a)) and the "percentage coverage requirement" (Internal Revenue Code, Section 410(b)), which affect the ability of small businesses to acquire other businesses;

- the Multiemployer Pension Plan Amendment Act (MPPAA), PL 96-364, which has imposed withdrawal liabilities that place heavy burdens on small employers and make it difficult for owners to sell firms;

- some parts of the Form 5500 (see 1982 Form 5500C), including: plan assets and investments (Question 15); administrative expenses (Question 16 and 18c); explanation of when a trustee is changed (Question 18a); detail on transactions (Question 19a); and detail on late contributions (Question 21d);

- the plan termination Form 5310, in particular supplying a ten-year salary average; when a plan is fully funded and 10 year cut backs do not apply;

- merger and spinoff rules relating to pensions, which are excessively complicated and necessitate expert assistance (Revenue Ruling 81-212 and IRS Regulations 1.401(a)-12 and 1.414(l)-1;

- TEFRA sections 240 and 241 which impose limitations on benefits to owner-operators, which decrease incentives for small employers to establish plans;

- the suspension of benefits-notice and the requirement that firms provide retirement information to employees nine months before they retire (DOL Regulation 2530.203-3 and Revenue Ruling 81-140 and IRS Regulation 1.401(a)-11);

- the requirement of an accountant audit in the case of insured plans or plans trusteed by a bank (ERISA Section 103(a)3);

- PBGC requirements on non-vested, former employees who have terminated employment, but who have not yet incurred a break in service (see definition of active participant on page 6 of 1983 Annual Premium Payment instructions); and

- IRS requirements for approval of a change of funding method when only minor details of the valuation method or assumptions have changed (ERISA Section 302(c)(6)).

Further investigation of the impacts of these type requirements on small firms should be undertaken.

Health Care Benefits

This study shows that the central issue with respect to health benefits in small firms is rising costs. Many of the small employers expressed concern over the spiraling costs of health benefits in recent years. In response to these increasing costs--which are estimated at eight to ten percent of pay--we found that small employers are changing insurance carriers and basic provisions of plans.

Overall, we found considerably higher rates of health benefit coverage than pension benefit coverage in small firms. However, higher rates of health care coverage still existed in larger firms compared to smaller firms. Both employers and employees regarded health plan coverage as an almost required benefit--one that is necessary if a firm is to attract and retain workers.

Cost containment was the overriding concern of the employers interviewed. In recent years, with health care premiums rising rapidly, small firms have begun to ask serious questions about whether they can afford to fully cover employees and about the type of coverage they can afford to offer. Increasingly, firms are instituting the following changes to their plans:

- they are moving away from high option coverage to standard coverage;
- employees are being asked to share in the costs of coverage by making monthly contributions to the cost of coverage;
- employers are adjusting plans to include higher deductibles; and
- firms are instituting co-insurance features, under which the employee pays some percentage of claims (e.g., 20% of cost above a certain level).

In general, employers have attempted to shift the costs of health coverage to employees--both to make them aware of cost increases and to help in meeting costs. Whether these measures will prove effective in curbing cost increases is still uncertain.

While cost containment is clearly the central issue facing small employers, small employers also noted several other important issues. One issue of concern is that smaller firms generally face higher premiums than larger firms because they are unable to pool risk across as many employees. In addition, if smaller firms have very high claims from several individuals during a given year, they face potentially precipitous increases in the upcoming year's premium. Larger firms, because they are able to pool risk spread costs across greater number of employees, are able to avoid these fluctuations in premiums. In addition, very small firms may find that they face a more restrictive set of choices in establishing benefits. Again, this is due to their inability to effectively pool risk. One way in which some small firms have countered these problems of costs and insurance availability is by joining small business organizations--which, in turn negotiate health care plans to cover their membership. By doing this, small business pool risk across employees in other small firms.

Finally, firms expressed some concern over administrative costs involved in processing claims. Small employers indicated that they could not afford the overhead costs involved in processing employee claims (as larger firms might be able to do). In response to this problem, small firms have selected plans with simplified claims procedures--under which the employee completes the claim forms and submits it directly to the insurance carrier.

APPENDIX A

ON-SITE CASE STUDIES OF THREE SMALL BUSINESSES

INTRODUCTION

In on-site case studies of three small businesses, we examined closely the administrative practices, costs, and effects of regulations on pension and health care plans. In these case studies, we placed particular attention on the activities and costs involved in setting up and maintaining benefit plans. We then used the findings from these case studies to supplement and extend the aggregate data analysis.

Using the Greater Cleveland Growth Association--a business organization located in the Cleveland, Ohio area--we selected three firms for case studies. These three firms were not intended to be random or fully representative of small businesses. In fact, we selected firms with different types of plans, different reasons for establishment of plans, varying administrative practices, and in different types of businesses.

Firm A is a small manufacturer of steel wire with about 15 employees, which set up a defined benefit plan in 1978. The owner-operator, who manages the plan assets, utilizes a financial planning service to administer the plan.

Firm B is a small moving and rigging firm, which employs 20 salaried management employees and up to 75 union employees. This firm established a profit sharing plan in 1981 for its management employees, and makes contributions to various pension plans set up for its union employees (e.g., Teamsters, Iron Workers, Operating Engineers and Millwrights). The firm relies extensively upon an outside plan administrator (a local bank) to file all forms and make investment recommendations.

Firm C is a real estate developer with about 20 employees. This small firm has a profit sharing plan which was established in 1973 and revised in 1977. The firm's president and a management employee are responsible for both plan administration and investment decisions.

We conducted interviews with the presidents of Firms A and B and the plan administrator of Firm C. A series of pre-planned questions, which appear in Exhibit A-1, were used to guide these discussions. However, considerable flexibility was permitted in the flow of conversations. We paid particular attention (and time) to pension discussions because of the complexity of pension regulations and administrative practices. In our interviews, we placed substantial emphasis on the impact of regulations on (1) the decision to offer plans and (2) the ongoing costs of the plans and any special problems.

EXHIBIT A-1

DISCUSSION GUIDE FOR ON-SITE CASE STUDIES

Pension Plan Questions

1. What type of pension plan do you have?
    - Are all of your employees eligible for the plan?
    - Is there a minimum age or service requirement?
    - What is your vesting provision?
2. When did your plan go into effect?
3. How long did it take your firm to set up the plan?
4. What major steps did your firm go through in originally setting up the plan?
5. Which of these steps was most burdensome? Why?
6. Who in your firm was involved in setting up the plan?
7. Who outside your firm was involved in setting up the plan?
8. What other costs were involved in setting up the plan?
9. Why did you select the type of plan that you did?
10. Did government regulation affect your decisions with regard to setting up a plan? How?
11. Did government regulation impose any additional costs or burdens in your firm when you were setting up your plan?
12. Who at your firm is involved in the on-going administration of your pension plan?
13. Who outside your firm is involved in the on-going administration of your pension plan?
14. What other costs are involved in the on-going administration of your pension plan?
15. Over the course of a calendar year, what are the major activities involved in administering the plan?

EXHIBIT A-1
(Continued)

DISCUSSION GUIDE FOR ON-SITE CASE STUDIES

16. What are the most burdensome aspects of the day-to-day management of the pension plan?

17. What forms does your firm complete to report on your pension plan?

18. Which forms (or parts of forms) are the most burdensome to complete?

19. Does government regulation affect on-going costs of administering plans? How? What is the most burdensome aspect of this regulation?

20. If you could change any one thing about pension plan administration, what would it be?

Health Plan Questions

1. What type of health care coverage do you have?

2. Who at your firm was involved in setting up the plan? Did you receive any outside assistance in setting up the plan?

3. What was the most burdensome aspect of setting up the plan?

4. Have you recently changed the type of coverage that you offer your employees? If yes, why?

5. Who at your firm is involved in on-going administration of your health plan? Does your firm receive any outside assistance in administering the plan?

6. What are the most burdensome aspects of the day-to-day administration of your plan? Does government regulation impose any burdens?

CASE STUDY: FIRM A

Description of Firm A

Firm A is a small, owner-operated manufacturer of steel wire with about 15 employees. This firm was established in 1974. We interviewed the firm's president, who set up the plan and currently manages its investments.

Description of the Pension Plan

Firm A has an integrated defined benefit plan. Currently, the firm's annual contributions are approximately five percent of pay. The plan was initiated in 1978, in the fourth year of the company's operation. The pension benefit at retirement is 23.5 percent of compensation under social security covered compensation plus 33 percent of the excess compensation. The plan is funded completely by a trust fund, with no life insurance involved. Eligibility for plan participation is 25 years of age and one year of service (where one year of service is defined by the 1,000 hours rule). The plan uses graded vesting starting at 25 percent after five years of service, grading to 50 percent after 10 years, and 100 percent after 15 years of service. Early retirement is permitted at age 60 with 15 years of service. Exhibit A-2 summarizes the plan characteristics.

Formation of the Pension Plan

Establishment of the Plan

The plan was established at the time of company incorporation (1978), four years after the company was established by the owner-operator. According to the company's president, who made the decision to establish the plan, the plan was initiated for three major reasons:

EXHIBIT A-2

PENSION PLAN CHARACTERISTICS OF FIRM A

Number of Employees	15
Product	Manufacturing of Steel Wire
Year Firm Established	1974
Type of Plan	Defined Benefit
Single vs. Multiemployer	Single
Reason for Selection of Particular Plan	Defined benefit plan provides a more substantial retirement benefit to the owner-operator.
Type of Employee Eligibility	All Employees
Minimum Age Requirements (Years)	25
Minimum Service Requirement (Years)	1
Vesting	25% after 5 years 50% after 10 years 100% after 15 years
Social Security Integration	Yes
Supplemental Plans	No
Early Retirement	Yes
Earliest Age/Service	60 years old/15 years
Loan/Withdrawal	Yes
Investments	Stocks, Bonds, Money Markets
Payment of Benefits	Directly from Fund

(1) The owner-operator wanted to provide protection for himself and his employees in case catastrophic circumstances led to company bankruptcy at some future time.

(2) The owner-operator (age 48) and most employees (in their 30's) were approaching ages at which they felt it was important to start setting aside funds for a pension plan.

(3) The company was then sufficiently profitable to set aside funds for the pension plan and the owner-operator was aware of the tax advantages of initiating a plan.

This firm initiated a defined benefit plan at the time of company incorporation in 1978, four years after the firm was established. At the time of formation, the firm had been profitable for several years. In response to this profitability, the owner-operator commissioned a financial planning firm to do a study on all aspects of the company's operations. One recommendation that emerged from this study was that the firm establish a pension plan.

The financial planning firm reviewed the major types of plan options with the owner-operator. On the recommendation of the financial advisor, the owner-operator selected a defined benefit plan because this plan would provide him with a more substantial retirement benefit than a defined contribution plan.

Once the type of plan was selected, the financial planning advisor developed a proposed plan document, which incorporated the major features selected by the owner-operator. After the company's attorney reviewed the plan document, Firm A adopted the plan. The financial advisor made a formal actuarial valuation and determined the size of the initial contribution. The plan document was then filed with the Internal Revenue Service. The owner-operator estimated that this entire plan formation process was completed over a 6-8 month period.

Impact of Regulations on the Plan Formation

Pension plan regulations were not a particular problem or obstacle to the owner-operator because he was only given choices by the pension consultant who assisted in setting up the plan that satisfied the regulations. However, government regulation clearly affected the owner-operator's decision to form a pension plan and the type of plan he selected. For example, the owner stated that favorable tax regulations--under which his firm could avoid corporate taxes and employees could defer personal income tax on payments made to their pension--clearly affected the decision to form a plan. In addition, the owner noted that regulations governing corporate bankruptcy--which insured that employees would receive pension benefits even if the firm went bankrupt--made establishment of a pension plan attractive. He had seen other owner-operators who had not established a plan, left with very little retirement income when their businesses failed as they approached retirement age.

Costs of Plan Formation

Within the firm, the owner-operator was the only employee directly involved in setting up the plan. Prior to plan initiation, numerous meetings with insurance agents made him aware of the complexities and many of the problems involved in setting up a retirement plan. When a management study recommending the plan was initiated, he spent an estimated 6-8 hours reviewing the study and the pension consultant's recommendations.

External to the firm, the owner-operator utilized financial planning, legal, and actuarial services. The initial management study, conducted by a financial planning firm, cost $700. This study included drafting a pension plan document. The company's attorney reviewed the pension plan document at an estimated cost of a few hundred dollars. The initial actuarial valuation and determination of firm contribution cost $350. Hence, expert assistance in setting up the plan was in the $1,000-1,500 range.

The owner-operator expressed concern over the administrative costs involved in setting up a plan, which he felt were a higher percentage of annual contributions for small firms than large firms. In addition, he felt that larger firms were more likely than smaller firms to have staff with expertise to assist in the steps of setting up a pension plan. He thought that small firms, like his own, generally needed to purchase "high priced advice" in order to establish a plan.

Problems in Plan Formation

The greatest problem the owner-operator faced in setting up the plan was conflicting advice offered by insurance agents. He commented that he was "disconcerted by conflicting advice" offered by these agents. In addition, the owner-operator felt uncomfortable being in an area of unfamiliarity--doubting that he could "make a good business decision" as he might make in other operational areas. He also stated that he "feared locking into one type of plan that would be unfavorable over the long term".

Ongoing Administration of the Pension Plan

Administrative Activities

Within the firm, the owner-operator performs the following administrative tasks:

- decision making concerning investment of pension plan assets (in consultation with his stockbroker);
- coordination of activities of the plan administrator;
- notification to the plan administrator about changes in employee status;

- compilation of statistical data for the plan administrator to prepare the Form 5500. He did not characterize these activities as particularly burdensome or time-consuming.

Initially, he had some difficulty understanding regulations and reporting requirements, but after a year he found on-going plan administration fairly "cut and dried". A secretary assists him with typing and other clerical tasks.

An actuarial firm acts as the plan administrator. This firm values the plan and estimates the required firm contributions. It also prepares employee benefit statements, the Form 5500C, and other filings. A stockbroker advises the owner-operator on investments at no charge. Use of legal and accounting services to resolve problems has been negligible in recent years.

Administrative Costs

The owner-operator spends an estimated eight hours per year administering the plan--most of which is spent on making investment decisions. He noted that only the tangible cost of on-going plan administration is an actuarial fee--which was initially $300 per year, but recently increased to $600 per year. This fee represented 5.4 percent of the annual contribution to the fund ($11,000). This fee covers preparation of the valuation to determine firm contributions as well as the preparation of employee benefit statements and forms. The owner-operator noted that, in the past, he had also incurred indirect costs in reviewing potential impacts of changed pension regulations, such as TEFRA.

Impact of Regulation on Plan Administration

The impact of regulations and reporting is not fully apparent to this owner-operator because most of the on-going administration is done by an actuarial firm. At one time, the owner-operator completed the Form 5500, but found it burdensome--particularly the portion relating to assets. Now, the plan administrator fills out the Form 5500. Overall, the owner-operator does not object to the concept of the Form 5500 and other reporting requirements, he only objects to unnecessary detail and the ordering of questions on the forms.

Problems in Plan Administration

The owner-operator stated that a small firm with a pension plan could face problems in acquiring another firm because of the "controlled group requirements". These requirements may force that company to provide a pension plan to employees in another purchased firm even though the profitability of this newly acquired firm may not be sufficient to sustain the pension plan. Potential buyers who do not have a pension plan are at a competitive advantage because they are not required to provide a pension plan for the employees of the purchased firm. The owner-operator stated that his firm had recently faced this problem when they tried to acquire another firm.

The impact of this situation appears to be greater on a small firm than a large firm because of the IRS's anti-discrimination rules on plan coverage. For example, a company with 10,000 employees can purchase a small firm with 10 employees and not have to provide that acquired firm with a pension plan because of the "percent coverage requirements". Under this provision, 70 percent or more of all employees, exclusive of short service, seasonal and part-time employees, must be covered or at least 70 percent of the employees, similarly defined must be eligible for coverage under the plan and at least 80 percent of all eligible employees must actively participate. A company with 20 employees could not meet participation requirements if they acquired this same firm (with 10 employees) without including the employees in their pension plan.

The owner-operator also thought that it was important to have TEFRA's "top heavy" restriction, but that this requirement may lead to unnecessary, premature plan terminations both as a result of increased administrative costs and the adverse impact on the owner-operator.

The owner-operator suggested changes in the Form 5500 that would enable firms to complete the form without outside expert advice. Also, he stated that while it was important to protect employees against employers who would abuse their pension plan, that these protections should not penalize employers who are not out to abuse the plan.

Health Plan Characteristics and Problems

For the first three years of the company's operation, health coverage was provided on an individual policy basis--covering primarily catastrophic illness. During the third year, a group comprehensive health coverage plan was purchased. The insurance company underwriting this plan required purchase of life insurance at the same time. This plan has a $100 deductible and 20 percent co-insurance.

This plan has a simplified claims administration package. Insured employees fill out a form at the time of each claim, which is submitted directly to the insurance underwriter. The cost of coverage for each employee is about $1,500 per year, which represents about eight percent of pay. This cost, however, includes both health and life insurance. Cost of health insurance is estimated at seven percent of pay. The company has no long term accident or disability coverage.

CASE STUDY: FIRM B

Description of the Firm

Firm B is a moving and rigging company which employs 20 salaried management employees and up to 75 union employees. The firm was established in the 1870's. Prior to 1976, company employees were covered under union pension plans (primarily the Teamster's plan). During the period from 1976 to 1981, several union employees moved into management positions. In 1981, business considerations (not relating to the pension plan) caused these salaried management employees to withdraw from their respective unions. We interviewed the president of the firm, who holds no stock in the firm, but who makes decisions regarding the benefit plans and who was one of the employees responsible for setting up the pension and health care plans.

Description of the Pension Plan

Nonunion employees of Firm B are covered by a profit sharing plan, for which a formula percent of pay (0-15 percent) based on profits in excess of a threshhold (approximately $200,000) are distributed each year. Although the plan was established in 1981, only one distribution has been made. The plan uses a "5-15" graded vesting schedule. Union employees are covered by several multiemployer plans, including Operating Engineers, Iron Workers, Teamsters, and Millwrights. Although regular contributions are made to these union plans on a cents per hour basis, the firm's management had little knowledge of the specific characteristics of these plans. Exhibit A-3 summarizes the major characteristics of Firm B's pension plans.

Formation of the Pension Plan

Establishment of the Plan

The non-union profit sharing plan was established in 1981, when several key employees moved into management positions and withdrew from their

EXHIBIT A-3

PENSION PLAN CHARACTERISTICS OF FIRM B

	Plan A	Plan B
Number of Employees	20	75
Product	Moving and Rigging	Moving and Rigging
Year Firm Established	1870's	1870's
Type of Plan	Profit Sharing	Several Multiemployer Union Plans
Single vs. Multiemployer	Single	Multiemployer
Reason for Selection of Particular Plan	Permitted distribution of firm profits to employees; to avoid making payment to Fund when firm was not profitable	Negotiated by various unions, including Teamsters, Operating Engineers, Iron Workers, and Millwrights
Type of Employee Eligibility	Non-Union Employees	Union Employees
Minimum Age Requirement (Years)	None	Varies by plan
Minimum Service Requirements (Years)	None	Varies by plan
Vesting	33% after 5 years 100% after 15 years	Varies by plan Varies by plan
Social Security Integration	No	Varies by plan
Supplemental Plans	No	N.A.
Early Retirement	N.A.	Varies by plan
Earliest Age	N.A.	Varies by plan
Loan/Withdrawal	Yes	Varies by plan
Investments	Stocks, Bonds	Varies by plan
Payment of Benefits	N.A.	Varies by plan

respective unions (primarily the Teamster's Union). This plan was set up to provide pension benefits for nonunion employees, who no longer were covered by union retirement plans. At the time of plan formation, the overriding concern was to provide coverage to non-union employees. Tax benefits for the firm and employees, while important, were a secondary consideration.

A profit sharing plan was selected to avoid having to pay pension benefits when the company was not profitable. This type of plan was desired over a defined benefit plan because it did not require a contribution in years when profits were below a threshhold. In addition, a profit sharing plan was desired (rather than a bonus plan) because it permitted a distribution of profits to employees that would be set aside for the employees' retirement. Company profits distributed through a bonus plan would be subject to immediate taxation, while profits placed into a pension plan would be subject to taxation in the future (at a lower tax rate in all probability).

The plan was set up over a six to eight month period. The president and two management employees (who eventually became plan trustees) met with a pension lawyer from the company's law firm. It was estimated that six to eight meetings were held with this lawyer, during which the lawyer provided advice about possible plan provisions and projections of costs.

Impact of Regulations on Plan Formation

While regulation was not a significant problem or barrier to setting up the profit sharing plan, it affected the decision to offer benefits, the type of plan selected, and the costs of establishing the plan. In response to a question as to whether pension regulations had been a problem in forming a plan, the president stated that it had not been because the attorney hired to establish the plan only set forth choices that met current regulations. The complexity and frequent changes in regulations governing pension plans meant that it was necessary for the firm to hire an attorney with expertise in formation of private pensions. This attorney guided the president and several management employees through the process of setting up the plan--proposing various options and eventually writing the plan document.

Motivation for plan establishment was to a large extent a function of tax benefits accrued to the firm and the employees. For example, the profit sharing plan proved to be an effective mechanism for distributing company profits to avoid corporate taxes, as well as to enable employees to defer taxation on the contributions.

Costs of Plan Formation

Within the firm, four employees--the president, a payroll officer, and two management employees--were involved in setting up the plan. The president and the two management employees had numerous (6-8) meetings with the company's lawyer to discuss plan options. A payroll officer provided necessary statistical information to the lawyer for projections of the plan cost over the upcoming years.

Outside the firm, a pension attorney was extensively involved in setting up the plan. It is estimated that he provided between 75 and 100 hours of consultation (at a cost under $10,000). In addition, a local bank was involved in setting up an account for the plan (at no cost to the firm).

Problems in Plan Formation

The most burdensome aspect of setting up the pension plan from the president's point of view was understanding the many complex options available. The president noted that it was necessary for a small firm to seek costly, expert advice in order to set up a plan.

Ongoing Administration of the Pension Plan

Administrative Activities

Since there has been only one distribution since plan formation in 1981, and the five years required for vesting has not elapsed, the need for plan administration has been slight. In general, the company does not (by choice) take an active role in plan administration or investment decisions within the firm.

The president estimated that plan trustees spend only several hours per year reviewing investment decisions. The president and two other plan trustees are occasionally involved in the approval of investment decisions by the plan administrator (which is a local bank). The president preferred to have a third party handle investment decisions because he did not have adequate time to make good investment decisions and felt that the "clear hindsight" of participants makes even good investment decisions look bad.

Also, within the firm, a payroll officer provides the plan administrator with payroll data (W-2 and related data) for the profit sharing distribution and Form 5500.

The firm relies extensively upon a local bank to administer the plan and make investment recommendations. This bank files all reporting forms, including the Form 5500. Because there has been only one profit sharing distribution and employees are not yet vested, there has been little need to discuss problems of on-going administration with the company's attorney. Hence, nearly all major on-going administrative activities, except for final decisions on investments, are delegated to the plan administrator (i.e., a local bank).

Administrative Costs

Since plan initiation, on-going administrative costs to the firms have been negligible. It is estimated that less than 10 hours of company time is spent on administration. As discussed above, the president and trustees approve investment recommendations and a payroll officer provides necessary data to the plan administrator. The plan administrator (i.e., a local bank) charges a one-half of one percent per year investment fee, which covers the cost of on-going administrative services (such as filling out the Form 5500). The president estimated that consultation with the company attorney has been less than two hours per year.

Impact of Regulation on Plan Administration

The president stated that his firm had not experienced difficulty with the profit sharing plan for nonunion employees because the plan was just two years old and was administered by a local bank. However, for the various multiemployer plans (covering the firm's union employees), he noted problems in keeping up with ERISA regulations and the Multiemployer Pension Plan Amendment Act (MPPAA). Because all reporting forms (e.g., Form 5500) are completed by the plan administrator, he did not report any problems with government forms.

Problems in Plan Administration

The president of the firm noted that regulations governing multiemployer plans (i.e., the Multiemployer Pension Plan Amendment Act) had contributed significantly to the failure of between 20-60 small trucking firms in the Northeastern Ohio area. He also stated that MPPAA regulations had undermined the formation of new trucking firms: he referred to regulations governing multiemployer plans as "the single most significant impediment to the formation of small trucking businesses". He stressed that the financial security of many owners of small firms had been undermined by MPPAA in that owners who had built firms over many years were unable to sell their businesses because of substantial increases in liability legislated by MPPAA.

Overall, he agreed with the concept of pension plan regulation, but objected to having liabilities imposed "midstream" by government legislation and regulation (particularly in reference to the MPPAA). For example, companies, such as his own, negotiated with unions on a "cents per hour" basis for plan contributions. The imposition of additional, undefined pension liabilities (mandated by ERISA and the MPPAA) after these agreements had been negotiated made it impossible to accurately bid contracts.

Health Plan Characteristics and Problems

The firm's president was keenly aware of increased health care costs. He recently changed coverage from Blue Cross/Blue Shield to an insurance company plan because of the increasing cost of coverage. He thought that employees needed to share in the cost of coverage for health care costs to be brought under control. Hence, he favored higher deductibles and co-insurance provisions, which made the employees aware of the cost of health care. He felt that there should be a social insurance which would spread the risk associated with medical coverage. For example, he objected to insurance companies charging higher rates to firms with higher claims costs.

CASE STUDY: FIRM C

Description of the Firm

Firm C is a real estate developer, with approximately 20 employees. This owner-operated establishment was purchased in 1959. We interviewed the in-house plan administrator, who completes all forms and manages the plan.

Description of the Pension Plan

Firm C has a profit sharing plan, under which the employer's contribution is entirely at the discretion of the company. There has been no contribution in the last two years. Prior to that, since plan inception in 1973, an annual distribution of 15 percent of compensation was made. Employees may also contribute up to 10 percent of their compensation to the plan. Administrative expenses and trustee's fees are paid by the employer. Both investment and certain legal expenses are paid out of the fund. Employees become participants in the plan on the anniversary or half anniversary after completing one year of service (based on the 1,000 hours rule). Vesting is graded, starting at 10 percent after one year and increasing by 10 percent per year. Under this schedule, employees become 100 percent vested after 10 years of service. Upon demonstration of need and approval of the trustees, employees may borrow against the vested portion of their account at the prevailing interest rate. Exhibit A-4 summarizes the characteristics of Firm C's pension plan.

Formation of the Pension Plan

The plan was established in 1973, when the firm had 12 employees. No further information was available on the formation of the plan because employees responsible for setting up the plan were no longer with the firm.

EXHIBIT A-4

PENSION PLAN CHARACTERISTICS OF FIRM C

Number of Employees	20
Product	Real Estate Developer
Year Firm Established	1959
Type of Plan	Profit Sharing
Single vs. Multiemployer	Single
Reason for Selection of Particular Plan	N.A.
Type of Employee Eligibility	All Employees
Minimum Age Requirements (Years)	None
Minimum Service Requirement (Years)	1
Vesting	10% after 1 year 100% after 10 years
Social Security Integration	No
Supplemental Plans	No
Early Retirement	N.A.
Earliest Age	N.A.
Loan/Withdrawal	Yes
Investments	Bank Account
Payment of Benefits	N.A.

On-Going Administration of the Pension Plan

Administrative Activities

Within the firm, the president, a plan administrator, and secretary are involved in on-going administration of the plan. The president makes investment decisions, determines the size of the annual contribution (if any), and makes decisions concerning loans/withdrawals from the plan. The plan administrator calculates the annual allocation, completes the Form 5500, oversees loans/withdrawals, and completes W-2 forms (when necessary) at the end of each year. The secretary provides some assistance--typing up the Form 5500, W-2 forms, and payroll data.

External to the firm, an accountant and lawyer occasionally review loans/withdrawals and other special situations.

Administrative Costs

The owner-operator spends an estimated 6-8 hours per year making investment, distribution, and other types of decisions. The plan administrator estimatad that he spends:

- six hours per month making deposits and allocations;
- twenty hours per year completing the Form 5500 and performing related calculations;
- seven hours per year filling out necessary W-2 forms and detailing pension allocations for each employee;
- several hours, from time-to-time, administering loans and withdrawals.

During these tasks, he is assisted by a secretary who spends less than eight hours per year.

Legal and accounting fees are each about $200 per year. The plan administrator indicated that he contacted the firm lawyer and accountant 6-8 times per year about administrative problems and special circumstances, such as withdrawals, loans, enrollment of new employees and changes in regulations.

Certain tasks were performed--particularly related to generating the Form 5500--on one of the company's small business computers (TRS-80, Model II using the VISICALC program). The plan administrator noted that Section 15 of Form 5500C, which covers assets and investments, accounted for a disproportionate amount of the time spent on completing this form.

Impact of Regulation

The plan administrator indicated that Section 15 of Form 5500C was excessively burdensome. He felt that some of the burden of reporting is necessary for the protection of employees. He noted that the development of the Form 5500R was a significant improvement over the Form 5500C. Because there have been no contributions over the past 2 years, TEFRA has had no impact. The plan administrator felt that ERISA was "long overdue" and that "policing" of private pension plans was a necessity.

Problems in Plan Administration

The plan administrator identified plan investments as a major problem area. He felt the company was too small (and busy) to have anyone in the firm providing well-informed investment advice and that the size of the pension fund was too small to justify hiring outside investment advice. As a result, he feared that some investment opportunities were missed.

Health Plan Characteristics and Problems

Because of rising health care premiums, the firm recently solicited bids for new health care coverage. This resulted in the replacement of a large insurance carrier by a small insurance carrier. The plan administrator noted that employees occasionally experienced difficulties and delays during hospital admission procedures because hospital administrators were not familiar with the coverage of this small insurer. Because hospitals were unsure of the extent of coverage under his firm's carrier, he said that his employees were sometimes required to submit proof of ability to pay costs prior to admission.

The plan administrator noted that there was very little government regulation or reporting requirements related to health care plans. He indicated that while his firm faced little paperwork or reporting with regard to its health plan, employees occasionally complained of the difficulty of having claims processed and confusion over types of treatment covered.

APPENDIX B

TWO CASE STUDIES OF ACTUARIAL CONSULTANTS

INTRODUCTION

In these two case studies we examined the types of administrative services provided to small firms by plan consultants and administrators. We conducted these interviews because so many small businesses have outside actuarial consultants and plan administrators. These consultants and administrators are uniquely well qualified to discuss the problems faced by small businesses in establishing and administering plans.

We emphasized the identification of the extent and types of services performed during plan formation and on-going administration by independent consultants. In addition, we interviewed consultants about the effects of regulation and special problems that small firms may face in setting up or administering plans. We interviewed representatives of two Washington area actuarial firms.

CASE STUDY A

Description of the Firm and Its Clients

This firm is a small actuarial consulting firm originally set up to serve the clients of an insurance agency, but which now serves approximately 800 pension and profit sharing plans. About 750 of these plans have under 100 participants. Over 500 have less than five participants, in many cases covering incorporated professionals (often doctors). The firm has installed approximately 150 plans in the past few years, of which over 115 have fewer than five employees. We interviewed two enrolled actuaries: One is the president of the firm and the other has the primary responsibility for all plan administration done by the firm.

Description of Pension Plans Administered

Most plans administered by this firm are defined benefit plans. However, they also administer a large number of profit sharing and other defined contribution plans. Although only defined benefit plans require the use of an enrolled actuary, an equally important reason that this firm has so many defined benefit plans is that this type of plan gives a more substantial benefit to the key employees of professional firms and other corporations who are responsible for setting up the plans. This firm provides a full range of administrative services for most plans that it works on. However, in some cases, the accountant for the plan sponsor does the Form 5500 and other administration.

Formation of Pension Plans

Establishment of the Plans

The two interviewees indicated that typically a client establishes a pension plan when the firm becomes sufficiently profitable for the owner to become concerned about the impact of taxes on company profits. This is particularly the case when company profits are passed onto the owner-operator as earned income. Plan formation frequently occurs several years after firm establishment--often at the time of incorporation. In fact, in the case of many small professional firms, a primary reason for incorporation is to establish a pension plan.

The interviewees have found that the initial impetus for formation of a retirement plan usually comes from an advisor on financial matters--e.g., a financial planner, accountant, insurance agent or attorney. They noted the primary reasons for plan establishment include (in approximate order of importance):

- avoidance of corporate taxes on profits, as well as tax deferral for the owner-operator and employees;
- desire of the owner to provide for his own personal retirement;
- desire of the firm to provide retirement benefits for employees; and
- desire of the firm to reward long service employees.

The decision about the type of plan to establish is often closely related to the age of the owner. Plans set up by owners under 35 years of age are generally some form of defined contribution plan. This type of plan gives a young owner a more substantial contribution than he would receive under a defined benefit plan. This type of plan is usually integrated with social security. For owners over the age of 35, an integrated defined benefit plan is often more beneficial. This is especially the case for a married owner who sets up his benefits based on assumed retirement at age 55 with a joint and survivor option in effect.

The actuaries felt that there is no fixed order of events involved in setting up plans, but indicated a pattern that roughly exists:

- a firm recognizes that a tax problem exists (often as the result of financial advice);
- discussions are conducted between the owner and an advisor to develop basic criteria and an outline of the type of plan desired;
- the advisor reviews a few numerical examples, including an actuarial valuation or valuations for the types of plan(s) under consideration;
- there is a formalizing of the plan (deciding on the details);
- the plan document is written;
- an initial formal actuarial valuation and company contribution is calculated; and
- the initial contribution is made and the formal plan is filed with the IRS.

Impact of Regulations on Plan Formation

The interviewed actuaries felt that there were three areas of regulations that affected choices made at time of plan formation. First, and most important, were tax regulations. Generally, clients were interested in having the type of plan that gave them the greatest tax shelter. Second, were PBGC regulations relating to the potential 30 percent of net worth liability that could be imposed in the case of plan termination. Finally, other ERISA regulations affected terms and characteristics of plans though were only a secondary concern because plan advisors did not offer options that failed to meet ERISA standards. For example, some clients asked for less generous vesting schedules or stricter participation standards or other options not permitted by ERISA. In these cases, the actuary simply stated that these options were not permitted. For small plans, especially those for doctors, Section 415 of the Internal Revenue Code which limits benefits and contributions is a major concern. This has become an even greater concern now that TEFRA has further restricted these limits. TEFRA's "top-heavy" rules are also a consideration.

Costs of Plan Formation

Generally the owner, an actuary, and an attorney are involved in setting up a plan. In addition, an accountant or other financial advisor may be involved. An attorney usually draws up the plan document, though, in some cases, an actuary may execute this task and a lawyer will review the plan document.

The interviewees estimate that--depending upon services performed and the complexity of the plan established and the number of employees (thus the number of calculations involved)--actuarial fees to set up most plans range from about $500 to $2,500. Legal fees generally range from $1,500 to $2,200. Hence, total costs range from about $2,000-$4,700.

The actuary felt that costs on a per participant basis were definitely higher for small plans. It costs essentially the same amount to set up a plan for two or three persons as it does to set up a plan for 100 persons. However, they noted that perhaps the important measure is cost per firm. That remains roughly the same whether the firm has 2 or 10 employees.

Problems in Plan Formation

The interviewed actuaries cited two problems relating to plan formation. First, they stated that there is no room for modification of standard plans approved by the IRS. In one example, a standard IRS plan was used as the plan document except that there was a minor change in vesting in the case of disability. In this case, the entire plan document had to be filed and reviewed by the IRS before the plan could be approved. These consultants thought that it would have made sense and saved the client and the IRS substantial time and expense if the one sentence that had been changed could have been filed. They also thought that it would make even more sense to have some flexible pre-approved plans available.

The two consultants identified TEFRA "top-heavy" rule and 415 limits as substantial problems. These regulations are designed to specifically address small plans to a greater extent than larger plans. However, the TEFRA imposed limits are made even more burdensome because the intent of Congress is not completely clear. The time involved in administering these new rules is a burden on both the firm and the plan administrator.

Ongoing Administration

Administrative Activities

This actuarial firm performs ongoing administration for most of its clients. In some cases, a client's accountant fills out the Form 5500 and related filings. Also, a client may rely on its lawyer to periodically review pension matters and unusual circumstances.

Administrative activities vary somewhat depending on the needs of each client. However, the following steps provide an approximate summary of major on-going administrative tasks.

(1) If there is some discretion permitted in the employer's contribution, the owner-operator (or other management employee) contacts the actuary to provide statistical information.

(2) This data--on salary levels, company earnings, etc.,--is used to develop preliminary projections of maximum and minimum contribution levels.

(3) These projections are used to determine the split in distribution levels between bonus and pension plans.

(4) After the board decides on the split, formal census and accounting information is sent to the actuary.

(5) The actuary performs the formal valuation, fills out Form 5500 and any related information, and provides information for individual benefit statements.

(6) The actuary sends copies of these to the client, his attorney, and in some cases, his accountant.

(7) Finally, the client reviews the information, makes any needed contributions, and files the forms.

Administrative Costs

Annual administration for small plans is generally limited to the year end processing (discussed above) relating to the annual contribution. The actuarial firm does most of this. Annual fees are approximately $500 depending on plan complexity either in terms of plan provisions or number of lives. It was estimated that the client, including the firm's lawyer, would not have to spend more than three of four hours each per year on pension matters.

Other normal ongoing expenses related to participant loans, vested benefit calculations for terminating employees, and retirement, death or other benefit calculations. The time and cost involved in these tasks is minimal--under a few hours per year by the client and less than a few hundred dollars worth of the consultant's time. Except possibly for loans, these transactions are infrequent. Often, no benefit payments occur in a given year.

Unusual events can increase pension ongoing administrative costs considerably. Changes in regulations or legislation and changes in the company make-up cause added administrative expenses. The actuary involved in administration had been with an insurance company at the time when initial ERISA regulations were enacted. She estimated that the administrative cost of changing the plan to comply with ERISA was approximately $1,500 per plan. In addition, the insurance company had to spend 50 to 60 hours to change its prototypes to bring them into compliance with ERISA. This represented an indirect cost on top of the estimated $1,500 per plan. Changes in ERISA regulations and tax laws in recent years have caused additional plan expenses both in actuarial fees for plan administration and in legal fees relating to document amendments. For example, changes in laws and regulations affecting pensions have occurred in each of the last four years, causing some plans to have to make amendments each year.

Another costly, unusual event is a merger or spin off. If small companies which merge do not have the same type of pension plan, a comparability study showing that benefits are nondiscriminatory has to be performed and a decision has to be made as to how plans will be changed to permit the merger. Asset allocation calculations are required in the case of a spin off of a defined benefit plan.

Impact of Regulations on Plan Administration

The two interviewed actuaries indicated that their clients' experience no major difficulties with regular on-going administration as a result of regulations since the actuarial firm fills out most forms such as the Form 5500. However, as discussed above, the actuaries indicated that frequent changes in laws and regulations during the past ten years has added to the costs of administering a pension plan. They also indicated the following problems with Form 5500:

Question 15 - requires unnecessary detail. Particularly questions relating to the percentage of plan assets and diversity of investments may have meaning for a larger plan but not for a small plan.

Question 16i and 18c - are ambiguous in the case of a plan for which the sponsor pays all administrative expenses outside of the fund. What the employer pays for administration over and above his pension contribution is irrelevant information.

Question 18a - request for an explanation of what a trustee, etc., was charged are unclear as to what type of explanation is needed.

Question 19a - requests detail on transactions which is unnecessary. If a plan abides by regulations relating to loans, having detail on all of the trivial transactions involved in loans causes an excessive amount of administration, especially for loans that are no longer outstanding. One plan filed a Form 5500C every three years. Although it had only four lives covered under the plan, numerous loans over that three year period of duration of less than six months meant that records had to be obtained on over 25 loans, most of which were no longer outstanding at the time of filing.

Question 21d - is ambiguous. It asks if any contribution has been late under the terms of the plan. A plan may call for a contribution "at the end of the plan year". Section 412 of ERISA gives 8½ months after the end of the plan year to make a contribution. A contribution that is in compliance with ERISA may technically be "more than three months past due under the terms of the plan".

In addition to problems with the Form 5500, the actuaries indicated that the plan termination Form 5310 is very burdensome on small plans. Supplying a 10 year salary average represents a considerable burden for a plan that is fully funded and for which 10 year cutbacks do not apply.

Finally, the actuaries indicated that merger and spin-offs rules unnecessarily create special problems for small plans. They indicated that there is a necessary cost associated with filings that meet a required regulatory need, but that the IRS adds unnecessary costs by specifying in its revenue rulings complicated procedures, especially in the case of spin-offs that do not occur on the plan year anniversary.1/ The IRS also requires Form 6088 for a professional corporation even if it is has no PBGC liability.

1/ A spin-off occurs when a company sells a plant or other portion of its employees. In the case of a small business, partners may decide to split up, each taking with them a portion of the employees. This is considered a spin-off. Revenue Ruling 81-212 specifies that pension plan assets and liabilities must be valued as of the actual date of the spin-off. This requires an additional full actuarial valuation even if the plan is fully funded. A more reasonable approach would be to permit the use of the most recent valuation and require the valuation as of the date of the actual spin off only if one of the plans is terminated within a five year period. A similar problem occurs when one person is transferred from one plan to another within a controlled group. In this case if a portion of one plan's assets are transferred a full spin-off valuation must be performed. Again, the more reasonable approach would be to permit use of the most recent valuation for the allocation and require the full valuation only if one of the plans terminates within five years. The more cumbersome approach is required by IRS Regulations 1.401(a)-12 and 1.414(l)-1 and Revenue Ruling 81-212.

Problems in Plan Administration

Aside from the inefficiencies discussed above, major on-going administrative problems relate to special situations. The biggest problem cited by the interviewees was the constant state of flux of regulations and laws. They felt that the adverse impact of numerous changes on plan administration could be greatly decreased if implementation in existing plans could be delayed for a few years so that numerous changes could be made at the same time. For example, if plans only needed to be amended once every three years to come into compliance with new legislation, at that time all required changes would be made. In most cases, there would be little or no adverse impact on the intent of the law resulting from this delay in implementation. The positive effect would be that fewer plans would terminate and more would be formed if sponsors did not fear the harassment of constantly changing laws and regulations.

CASE STUDY B

Description of the Firm and Its Clients

This firm is a medium sized actuarial consulting firm serving 1,500 clients, many of which have less than 100 employees. This firm has a diversified clientele, including many small professional corporations. We interviewed both a plan administrator and an enrolled actuary. The actuary reviews approximately 100 pension plans for small companies (under 100 employees) and about 50 for larger companies.

Description of Pension Plans Administered

Most of the 150 plans administered by the interviewed actuary are integrated, final average salary, defined benefit plans. Only about two percent have formulas not related to final average salary, 80 percent are integrated, 18 percent are based on a level percent of final average salary, while the rest are based on final average salary and service. Most small plans have 25 years of age and 1 year of service participation requirements and "4/40" vesting. This actuarial firm performs all administrative services as well as the actuarial valuations for most of its small clients.

Formation of Pension Plans

Establishment of the Plans

The actuary finds that most smaller plans are set up when the firm becomes sufficiently profitable for the owner to be concerned about tax implications of earnings. In fact, he indicated that most plans are not formed until the last month before the end of a fiscal year, when the owner knows what the firm's profitability will be for that year. In some cases, the proximity of the owner to retirement age is a factor. Tax considerations are important in nearly all cases of new small plan formation--about half are formed for this reason alone. The owner's personal retirement income and/or concern about employee welfare are often important considerations. The actuary noted that many larger plans are formed either out of concern for employee welfare or as a matter of meeting competition.

The actuary indicated that a plan is formed typically because an attorney or accountant has made a plan sponsor aware of the tax benefits in setting up a plan. The actuary indicated that insurance agents also are involved in pension plan formation. However, he noted that plans set up by insurance agents usually have their administration and actuarial work done by insurance companies so he would not be apt to see these plans.

The actuary stated that the steps involve in setting up a plan are typically:

- the company realizes a substantial profit,
- an accountant, actuary, insurance agent or lawyer recommends the establishment of a plan because of tax advantages,
- the firm requests a study,
- an insurance company or actuary prepares a study outlining costs of various plans,
- a plan is selected,
- final valuation is performed,
- a trust established and initial contributions made, and
- plan documents are drawn up and IRS filings completed.

For small firms, usually only the president, assisted by an actuary and attorney, is involved in the plan formation process. Because there is generally a deadline for filing the contribution, the plan formation (i.e., through the point of making the first actual contribution) usually takes a couple of months. The employer usually waits until the end of a plan year to initiate the process and the contribution is due soon thereafter. The IRS filing of the plan document need not be completed prior to the time of the contribution.

Impact of Regulations on Plan Formation

The actuary felt that the forms and filings required in setting up a plan were not unduly burdensome, but rather that they were required for protection of plan participants. Generally, small plans choose those provisions which provide the largest benefit for the owner. The actuary indicated that it was not the regulations that were so much the problem, but rather how the regulations had been implemented. As a result of the frequent changes in pension rules, some potential plan sponsors have been hesitant to set up plans, fearing further changes in laws. They are not greatly hindered by the laws themselves, but rather with the uncertainty that constant change has caused regarding future regulations. They feel that the costs of complying are often not worth the benefits.

Costs of Plan Formation

Within a client company, usually the president is the only person involved in setting up a pension plan. He will usually spend less than eight hours--a two hour meeting reviewing with the actuary and/or attorney the objectives of the plan, a two hour meeting to choose the plan, a two hour meeting deciding upon plan document provisions and one hour collecting census data.

The cost of outside professional assistance was estimated at about $5,000. If the actuary drafts the plan document, performs needed valuations and does an initial study, fees would be about $4,000. In addition, a lawyer's fees for reviewing documents would be $500. If the attorney drafts the document, the actuary's fees would be about $3,000 and the attorney's fees about $2,000. Hence, total costs of assistance are in the $4,500-$5,000 range for plan formation. Other costs might include trust fees, a fidelity bond for the plan, PBGC premiums, and fees to accountants.

Problems in Plan Formation

The actuary did not identify any problems associated with setting up pension plans. However, he noted that TEFRA and the uncertainty created by repeated changes in pension laws have made the atmosphere less conducive to the establishment of new plans.

Ongoing Administration of Pension Plans

Administrative Activities

This actuarial firm finds that only a few larger companies, generally with well over 100 employees, do their own pension plan administration. In some instances, the plan sponsor's accountant prepares the Form 5500. However, for most clients, and all small clients, this actuarial firm performs all plan administration. The primary person from the plan sponsor's company involved is the president. The second-in-command rarely gets involved in pension issues. The president makes decisions, provides data, and signs documents for filing. External to the company, an attorney and an accountant may be involved, mainly to review information and filings. Also, a bank or some other financial institution may be involved in investing plan assets.

Costs of Plan Administration

This actuarial firm estimated that for a plan involving less than 15 participants, on-going administration fees would be about $1,000. For larger defined benefit plans, the fees would range from $1,500 to $2,500 for all services including valuation, filings, individual benefit statements and all plan record-keeping and about $500 less if record-keeping and individual benefit statements are not provided. Administration for defined contribution plans, where an actuarial valuation is not required, would be about $1,000 for larger plans. The actuary estimated that less than five hours of time is required by the plan sponsor. Usually the involvement of the company attorney and accountant is minimal--probably less than a few hundred dollars per year in fees. Other ongoing administrative expenses would be those related to benefit pay-outs and plan changes due to regulatory or legislative changes. The cost of benefit calculations is minimal. However, the amendment of a plan document that may be required as a result of a change in the law can run as much as $2,000.

Impact of Regulation on Plan Administration

The actuary thought that filing requirements are needed. He noted that although the cost per covered employee is much higher for small plans, it is, in fact, in the small plan area that there is the greatest abuse of pension plans. He thought that relaxation of filing requirements might be possible in the case of certain standard, very simple plans such as non-integrated plans permitting no loans, having a bank or other financial institution as a trustee and having an enrolled actuary do all of the administration. More complicated plans--for example, those that fund toward retirement at age 55 and in other ways stretched the limits of regulations--needed to meet more extensive filing requirements.

Although the actuary agreed with the spirit of filing requirements, he felt that certain aspects of reporting and disclosure are carried to a burdensome extreme. The new Form 5500R is more time consuming than the old form and filling it out only every third year is often more of a burden than it was filing the old Form 5500C every year. In addition to the Form 5500, a plan has to file:

- joint and survivor notices nine months before an employee is eligible for early retirement,
- suspension of benefit notices after an employee reaches age 65 in certain plans,
- summary annual reports,
- summary plan descriptions,
- summary of material modification notices, and
- PBGC premium reports.

He also felt that the Financial Accounting Standard Bureau (FASB) proposal, regarding how to expense pension contributions, may become an excessive burden on pension plans.

Problems in Plan Administration

The actuary and plan administrator noted that one of the biggest problems has been frequent changes in laws and regulations governing pensions--requiring employers to amend their plans almost every year. Changes can double or triple the annual administrative cost of maintaining a small plan. In addition, changes can have substantial impacts on the extent of coverage and benefit levels--e.g., TEFRA limits the benefits to the owner-operator.

The actuary cited several specific areas of regulation that are unnecessarily burdensome:

- The suspension of benefits notice is unnecessary. Employees already receive a summary plan description and can always come to the plan administrator to review their benefits. Workers who decide to work past age 65 generally research the issue and finds out what the impact is on pension benefits independent of receiving the suspension of benefits notice.
- The requirement of providing retirement information nine months prior to the employee's retirement date is unnecessary. Exact figures are provided when the employee retires. Prior to that, the employee receives or can request a benefit statement on an annual basis.
- The requirement of an accountant audit in the case of insured plans is useless since there is nothing to audit. This is also true for plans trusteed by banks.
- PBGC requires that plans count as participants non-vested former employees who have terminated employment but who have not yet incurred a break in service. The actuary estimates that less than one percent of these former employees ever return to employment. Keeping track of all these incomplete breaks in service creates an unnecessary record-keeping burden.
- The IRS requires a plan to obtain approval of a change of funding method even when certain details of the valuation are changed. This can unnecessarily cost a plan several hundred dollars and create unnecessary work for the IRS.

APPENDIX C

TELEPHONE INTERVIEWS OF SMALL EMPLOYERS

We conducted a number of telephone interviews to supplement the analyses of aggregate data. In particular, these interviews were structured so that they would provide the following types of information:

- reasons small firms did or did not have pension and/or health benefit plans;
- characteristics of pension and/or health benefit plans; and
- costs and administrative practices involved in benefit plans.

We contacted two small business organizations--the Greater Cleveland Growth Association and the Smaller Manufacturer's Council of Pittsburgh--concerning the selection of interviews with small employers. Because the aim of these interviews was to conduct detailed discussions about employee benefits with a small number of firms, an effort was made to select firms that varied across several key factors (e.g., size, type of product, year of establishment, etc.).

Eight interviews were conducted with small firms with pension plans in the Pittsburgh and Cleveland area. Another seven interviews were conducted with small firms that did not have pension plans. In addition, each of the fifteen firms--all of which had health plans--were interviewed about their health plans.

Discussions were generally conducted with the president (or chief executive officer) of the selected firms. Those firms who currently did not have a pension plan were asked the following types of questions:

- Why do you not have a pension plan (i.e., what factors have affected your decision not to offer pension benefits)?

- What would be the most important factor in your firm's decision to provide pension benefits in the future?
- Did government regulation or paperwork involved in setting up and administering a plan affect your decision? How?
- Do you currently have plans to establish a pension or profit sharing plan during the upcoming year?

Those firms that currently had a pension plan were asked a different set of questions that probed the characteristics of the plan, reasons for setting up the plan, administrative practices, and problems associated with plan administration. For example, some of the questions asked these firms included:

- Are all of your employees eligible for the plan? If not, who is not eligible?
- How many employees currently participate in your pension or profit sharing plan?
- Is there a minimum age or service requirement for participation? If yes, what is the minimum age or service requirement?
- What is your vesting provision?
- What type of pension plan do you have?
- Who manages the plan assets?
- How are the pension plan assets invested?
- Were there any particular reasons that you selected the plan that you did?
- What obstacles or barriers did your firm face in setting up the plan?

Finally, firms were asked a set of questions about their health care plans. These questions probed characteristics, administrative practices, costs, reasons for setting up the plan, and problems encountered in setting up and administering health benefits.

Exhibit C-1 provides a description of the basic characteristics of the pension plans in the eight firms interviewed by telephone with plans. Exhibit C-2 provides a description of the characteristics of health care plans in the fifteen firms interviewed by telephone.

EXHIBIT C-1

CHARACTERISTICS OF PENSION PLANS, TELEPHONE INTERVIEWS

Firm 3

Number of Employees	11
Product	Printing Services
Year Firm Established	1963
Type of Plan	Profit Sharing
Single vs. Multiemployer	Single
Reason for Selection of Particular Plan	To avoid paperwork and administrative expense
Type of Employee Eligibility	All Employees
Minimum Age Requirements (Years)	None
Minimum Service Requirement (Years)	1
Vesting	12.5% per year 100% after 8 years
Social Security Integration	N.A.
Supplemental Plans	None
Early Retirement	N.A.
Earliest Age	N.A.
Loan/Withdrawal	Yes
Investments	Common Stocks, Bonds
Payment of Benefits	Directly from fund

EXHIBIT C-1
(Continued)

CHARACTERISTICS OF PENSION PLANS, TELEPHONE INTERVIEWS

Firm 7

Number of Employees	25
Product	Manufacturing Machinery
Year Firm Established	1953
Type of Plan	Defined Benefit
Single vs. Multiemployer	Single
Reason for Selection of Particular Plan	Selected least risky type of plan; wanted to minimize involvement in investment decisions.
Type of Employee Eligibility	All Employees
Minimum Age Requirements (Years)	25
Minimum Service Requirement (Years)	1
Vesting	10% per year 100% after 10 years
Social Security Integration	Yes
Supplemental Plans	None
Early Retirement	Yes
Earliest Age	N.A.
Loan/Withdrawal	No
Investments	N.A.
Payment of Benefits	Purchase of Annuities

EXHIBIT C-1
(Continued)

CHARACTERISTICS OF PENSION PLANS, TELEPHONE INTERVIEWS

Firm 9

	Plan A (Hourly)	Plan B (Salaried)
Number of Employees	a/	a/
Product	Manufacturing Springs	Manufacturing Springs
Year Firm Established	1941	1941
Type of Plan	Defined Contribution	Defined Benefit
Single vs. Multiemployer	Single	Single
Reason for Selection of Particular Plan	Wanted plan to work to advantage of young salaried employees	Resulted from union negotiations and union concerned that employees are able to know what they will receive at retirement
Type of Employee Eligibility	Salaried Employees	Hourly (Union) Employees
Minimum Age Requirement (Years)	23	None
Minimum Service Requirements (Years)	1	None
Vesting	50% after 5 years 100% after 10 years	50% after 5 years 100% after 10 years
Social Security Integration	Yes	No
Supplemental Plans	No	No
Early Retirement Earliest Age	Yes 62 years	Yes 62 years
Loan/Withdrawal Investments	Yes Annuities	No --
Payment of Benefits	Directly from fund or purchase of annuities	--

a/ 32 employees in the firm.

EXHIBIT C-1
(Continued)

CHARACTERISTICS OF PENSION PLANS, TELEPHONE INTERVIEWS

Firm 10

Number of Employees	42
Product	Chemical
Year Firm Established	1964
Type of Plan	Profit Sharing
Single vs. Multiemployer	Single
Reason for Selection of Particular Plan	Minimize administration and reporting and too small at plan initiation to go with other type of plan
Type of Employee Eligibility	All employees except commissioned sales persons
Minimum Age Requirements (Years)	None
Minimum Service Requirement (Years)	I
Vesting	10% after 1 year 100% after 10 years
Social Security Integration	N.A.
Supplemental Plans	No
Early Retirement	N.A.
Earliest Age	N.A.
Loan/Withdrawal	No
Investments	Common Stocks, Money Markets
Payment of Benefits	Directly from fund

EXHIBIT C-1
(Continued)

CHARACTERISTICS OF PENSION PLANS, TELEPHONE INTERVIEWS

Firm 11

Number of Employees	47
Product	Quality Control Systems
Year Firm Established	1948
Type of Plan	Profit Sharing
Single vs. Multiemployer	Single
Reason for Selection of Particular Plan	N.A.
Type of Employee Eligibility	All Employees
Minimum Age Requirements (Years)	None
Minimum Service Requirement (Years)	1
Vesting	N.A. 100% after 10 years
Social Security Integration	None
Supplemental Plans	No
Early Retirement	N.A.
Earliest Age	N.A.
Loan/Withdrawal	No
Investments	Common Stocks, Bonds
Payment of Benefits	Directly from Fund

EXHIBIT C-1
(Continued)

CHARACTERISTICS OF PENSION PLANS, TELEPHONE INTERVIEWS

Firm 12

Number of Employees	53
Product	Equipment Distribution
Year Firm Established	1963
Type of Plan	Profit Sharing
Single vs. Multiemployer	Single
Reason for Selection of Particular Plan	To avoid ERISA to the extent possible and to avoid getting "trapped" into bankruptcy by plan
Type of Employee Eligibility	All Employees
Minimum Age Requirements (Years)	25
Minimum Service Requirement (Years)	1
Vesting	10% after 5 years 100% after 10 years
Social Security Integration	N.A.
Supplemental Plans	No, but looked into 401K
Early Retirement	N.A.
Earliest Age	N.A.
Loan/Withdrawal	No
Investments	Insurance Co. investments
Payment of Benefits	Directly from Fund

EXHIBIT C-1
(Continued)

CHARACTERISTICS OF PENSION PLANS, TELEPHONE INTERVIEWS

Firm 14

	Plan A (Salaried)	Plan B (Hourly)
Number of Employees	25	90
Product	Steel Lockers	Steel Lockers
Year Firm Established	1930	1930
Type of Plan	Profit Sharing	Defined Benefit
Single vs. Multiemployer	Single	Multiemployer
Reason for Selection of Particular Plan	N.A.	N.A.
Type of Employee Eligibility	Salaried Employees	Hourly (Union) Employees
Minimum Age Requirement (Years)	24	N.A.
Minimum Service Requirements (Years)	1/2	N.A.
Vesting	20% after 2 years 100% after 10 years	100% after 10 years
Social Security Integration	N.A.	N.A.
Supplemental Plans	No	No
Early Retirement	N.A.	N.A.
Earliest Age	N.A.	N.A.
Loan/Withdrawal	No	N.A.
Investments	Common stocks, Bonds, General Assets	N.A.
Payment of Benefits	Directly from fund or purchase of annuities	N.A.

EXHIBIT C-1
(Continued)

CHARACTERISTICS OF PENSION PLANS, TELEPHONE INTERVIEWS

Firm 15

	Plan A (Salaried)	Plan B (Hourly)
Number of Employees	99	75
Product	Combustion Equipment	Combustion Equipment
Year Firm Established	1934	1934
Type of Plan	Defined Benefit	Defined Contribution
Single vs. Multiemployer	Single	Single
Reason for Selection of Particular Plan	Owner-operator felt at the time that "a defined benefit plan was the best way to go from the employee's standpoint"	N.A.
Type of Employee Eligibility	Salaried Employees	Hourly Employees
Minimum Age Requirement (Years)	25	25
Minimum Service Requirements (Years)	1	1
Vesting	33% after 5 years 100% after 15 years	N.A. 100% after 10 years
Social Security Integration	No	No
Supplemental Plans	No	No
Early Retirement	Yes	
Earliest Age	55 years old; 15 years of service	N.A.
Loan/Withdrawal	No	N.A.
Investments	Bank Account, Short-term G-Maes	N.A.
Payment of Benefits	Directly from fund or purchase of annuities	N.A.

EXHIBIT C-2

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 1

Number of Employees	4
Product	Plastic Fabricating
Year Established	1966
Type of Health Insurance	Blue Cross/Blue Shield
Type of Coverage	Major Medical/Physician Services
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	60 days
c) Minimum Hours	20 hours/week
Deductible (per year)	$200/family
HMO Offered	No
Reasons for Establishing Coverage	o owner-operator wanted to take care of own needs o give employees "peace of mind"
Reason for Particular Plan	o offered by local business association o plan was easy to institute, well-priced and easy to administer

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 2

Number of Employees	8
Product	Wiring Materials
Year Established	1911
Type of Health Insurance	a) Blue Cross/Blue Shield b) Insurance Company
Type of Coverage	Major Medical/Physician Services
Eligibility Requirements	
a) Employee Status	Salaried employees/BC-BS
b) Service Requirements	60 days
c) Minimum Hours	None
Deductible (per year)	None
HMO Offered	No
Reasons for Establishing Coverage	o management felt employees needed coverage o tried to match salaried plan to medical coverage offered through union
Reason for Particular Plan	o convenience of setting up and managing the plan

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 3

Number of Employees	11
Product	Printing Services
Year Established	1963
Type of Health Insurance	Insurance Company
Type of Coverage	Major Medical/Physician Services
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	60 days
c) Minimum Hours	20 hours/week
Deductible (per year)	$100/individual $200/family
HMO Offered	No
Reasons for Establishing Coverage	o management felt employees needed coverage
Reason for Particular Plan	o former plan became too expensive o carrier was a good customer o wanted protection against catastrophic claims

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 4

Number of Employees	14
Product	Pipe Stoppers
Year Established	1973
Type of Health Insurance	Blue Cross-Blue Shield
Type of Coverage	Major Medical
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	90 days
c) Minimum Hours	None
Deductible (per year)	$100/individual
HMO Offered	No
Reasons for Establishing Coverage	N.A.
Reason for Particular Plan	o former plan became too expensive o easily procured through local business organization

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 5

Number of Employees	15
Product	Air Valves
Year Established	1974
Type of Health Insurance	Insurance Company
Type of Coverage	Major Medical/Physician Services
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	60 days
c) Minimum Hours	32 hours/week
Deductible (per year)	$100/individual $200/family
HMO Offered	No
Reasons for Establishing Coverage	o owner-operator wanted employees to be covered
Reason for Particular Plan	o less expensive and higher level of coverage versus other plans

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 6

Number of Employees	22
Product	Certified Public Accountant/Management Consultant
Year Established	1973
Type of Health Insurance	Insurance Company
Type of Coverage	Major Medical/Physician Services
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	None
c) Minimum Hours	None
Deductible (per year)	$200/family
HMO Offered	No
Reasons for Establishing Coverage	o management felt employees were entitled to health coverage o to remain competitive in labor market
Reason for Particular Plan	o less expensive than other type of plans

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 7

Number of Employees	25
Product	Machinery
Year Established	1953
Type of Health Insurance	a) Blue Cross-Blue Shield b) HMO
Type of Coverage	Major Medical/Physician Services
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	30 days
c) Minimum Hours	1,000 hours/year
Deductible (per year)	a) $200/individual, $400/family (BC-BS) b) None (HMO)
HMO Offered	Yes
Reasons for Establishing Coverage	o to remain competitive in the labor market
Reason for Particular Plan	o best coverage available at time o government required provision of HMO option

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 8

Number of Employees	25
Product	Pest Control Services
Year Established	1908
Type of Health Insurance	a) Blue Cross-Blue Shield b) HMO
Type of Coverage	Major Medical/Physician Services
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	90 days
c) Minimum Hours	40 hours/week
Deductible (per year)	a) $200/individual, $400/family (BC-BS) b) None (HMO)
HMO Offered	Yes
Reasons for Establishing Coverage	N.A.
Reason for Particular Plan	o recently changed from other insurance company to reduce cost and red tape

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 9

Number of Employees	32
Product	Wire Springs
Year Established	1961
Type of Health Insurance	Blue Cross-Blue Shield
Type of Coverage	Major Medical
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	60 days
c) Minimum Hours	
Deductible (per year)	None
HMO Offered	No
Reasons for Establishing Coverage	o offered as a benefit to entice/hold employees o to remain competitive in labor marketplace
Reason for Particular Plan	o this plan was most competitive in area o received very few complaints from employees

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 10

Number of Employees	42
Product	Chemical Products
Year Established	1984
Type of Health Insurance	a) Blue Cross-Blue Shield b) HMO
Type of Coverage	Major Medical/Physician Services
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	90 days
c) Minimum Hours	40 hours/week
Deductible (per year)	a) $200/individual; $600/family (BC-BS) b) None (HMO)
HMO Offered	Yes
Reasons for Establishing Coverage	N.A.
Reason for Particular Plan	o cost was the overriding factor

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 11

Number of Employees	47
Product	Quality Control Systems
Year Established	1968
Type of Health Insurance	Self-Insurance
Type of Coverage	Major Medical
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	3-6 months
c) Minimum Hours	None
Deductible (per year)	$100/individual
HMO Offered	No
Reasons for Establishing Coverage	N.A.
Reason for Particular Plan	o Felt self-insurance would be a money-saver

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 12

Number of Employees	53
Product	Distributors
Year Established	1963
Type of Health Insurance	a) Insurance Company b) HMO
Type of Coverage	Major Medical/Physician Services
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	6 months
c) Minimum Hours	None
Deductible (per year)	$100/individual; $100/family
HMO Offered	Yes
Reasons for Establishing Coverage	o to remain competitive in the labor market
Reason for Particular Plan	o went to independent carrier recently to save money

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 13

Number of Employees	115
Product	Electric Coils/Transit Equipment
Year Established	1975
Type of Health Insurance	Self Insurance
Type of Coverage	Major Medical/Physician Services
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	90 days
c) Minimum Hours	40 hours/week
Deductible (per year)	$100/individual
HMO Offered	No
Reasons for Establishing Coverage	o employees wanted to be covered o benefit was tax deductible
Reason for Particular Plan	o selected self-insurance because: - greatest cost-control and flexibility - could write own plan - could administer own plan

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 14

Number of Employees	125
Product	Steel Lockers
Year Established	1930
Type of Health Insurance	a) Insurance Company b) 2 HMOs
Type of Coverage	Major Medical/Physician Services
Eligibility Requirements	
a) Employee Status	All employees
b) Service Requirements	60 days
c) Minimum Hours	None
Deductible (per year)	a) $100/individual; $200/family (Insurance Company) b) None (HMO)
HMO Offered	Yes
Reasons for Establishing Coverage	N.A.
Reason for Particular Plan	o shopped around and found plan was least expensive and met basic service requirements

EXHIBIT C-2
(Continued)

CHARACTERISTICS OF HEALTH CARE PLANS, TELEPHONE INTERVIEWS WITH FIFTEEN FIRMS

Firm 15

Number of Employees	174
Product	Industrial Combustion Equipment
Year Established	1934
Type of Health Insurance	a) Blue Cross-Blue Shield b) Insurance Company c) HMO
Type of Coverage	Major Medical/Physician Services
Eligibility Requirements	
a) Employee Status	a) Hourly Employees-BC/BS b) Salaried Employees-Ins. Co./HMO
b) Service Requirements	First of Month (Salaried)
c) Minimum Hours	None
Deductible (per year)	None
HMO Offered	Yes
Reasons for Establishing Coverage	o to remain competitive in the labor marketplace
Reason for Particular Plan	o hourly plan negotiated through union o salaried plan featured best service for cost o government required HMO option

APPENDIX D

DESCRIPTION OF SBANE AND SMC SURVEYS

We used data from two regional data bases during this project to extend our aggregate data analyses: (1) a 1982 Survey of Employee Benefits, conducted by the Small Business Association of New England (SBANE) and Griffin Pension Services, Inc.; and (2) the 1982 SMC Survey of Wage and Fringe Benefits, conducted by the Smaller Manufacturer's Council (SMC) of Pittsburgh.

The SBANE survey was conducted with 176 firms in the Greater Boston area. All but one of these firms employed under 500 workers. The survey included questions on the following types of employee benefits: health insurance, dental insurance, group life insurance, paid vacations and holidays, paid personal days, non-insured sick pay, short-term disability insurance, long term disability insurance, retirement and savings plans, educational reimbursement, special benefits, and bonus plans.

The SMC survey is conducted annually. It surveyed 242 firms in 1982 in the Greater Pittsburgh area, 240 of which had fewer than 500 employees. This survey asked questions about the wages, paid leave and vacations, pension plans, bonus plans, group life insurance, sickness and accident insurance, hospital and surgical insurance, major medical, dental insurance, and Health Maintenance Organization coverage.

The SBANE and SMC Surveys did not use random sampling procedures. A copy of the two survey instruments are included in Exhibit D-1.

APPENDIX E

SUMMARY OF NEEDS SPECIFICATION INTERVIEWS

INTRODUCTION

"Needs Specification" is designed to help target information collection and analysis so that research products meet the needs and requirements of policy decision-makers. It involves identifying key individuals in the policy-making process, then holding discussions with them to gain information concerning major policy issues, gaps in knowledge or data, priorities among basic research questions and information about the schedule for future policy decisions.

In this project, project staff conducted nine in-person and telephone discussions with congressional staff members, independent experts, and representatives of small business interests. The following agencies/ organizations were represented:

- Senate Finance Committee (Tax Counsel for the Minority);
- Senate Committee on Labor and Human Resources (Chief Counsel);
- Joint Committee on Taxation (Legislative Attorney);
- Employee Benefit Research Institute (EBRI), (Research Director);
- Urban Institute (Director of the Income, Security and Pension Policy Center);
- Griffin Pension Service (President);
- Greater Cleveland Growth Association (Director of the Council on Smaller Enterprises);
- Smaller Manufacturers Council of Pittsburgh (Executive Vice President);
- National Federation of Independent Business (Research Staff).

A non-representative sample of interviewees was selected on the basis of expertise in the area of employee benefits, as well as an ability to offer different perspectives on the major topics of this study. Five of the nine interviews were conducted in-person; the other four were conducted by telephone. The interviews, which lasted between 30 minutes and an hour, were free-flowing discussions, loosely-structured around several topic areas, including: current knowledge and data gaps; proposed scope and research questions of this study; basic methodology of this study; proposed research products and their uses; and the anticipated schedule for important policy decisions affecting pension and health care regulations.

MAJOR FINDINGS

The need specification interviewees expressed strong support for the basic scope and objectives of this study, particularly citing the need for development of current and reliable information about employee benefits in smaller firms.

Citing the lack of current and reliable data on employee benefits in small firms, interviewees generally agreed that the study should focus on issues of coverage, characteristics, costs, and factors affecting costs of pension and health care plans in small firms. Respondents felt that the methodology was sound--particularly, identifying the interviews and case studies of small employers as valuable and cost-effective methods. They felt that it was vital that the research project not be overly "academic" and that it be closely linked to current legislative initiatives.

In discussions concerning the scope and major research topics of this study, interviewees expressed particular interest in the following areas:

- development of cost data related to the formation/administration of pension and health care benefits in smaller firms;

- analysis of the effect of recent legislation (e.g., effects of the "top heavy" regulations in recent TEFRA legislation) and proposed legislation (e.g., effects of taxing employee health benefits) on the provision of employee benefits within small firms;
- collection and analysis of current information on the extent and characteristics of benefit plans within small firms;
- assessment of the "stages" that small business firms go through in establishing a set of benefits and the factors that seem to be most important during the decision-making process.

In reviewing the major research topics (i.e., extent of coverage, characteristics, costs, and factors effecting costs of pension and health care benefits), as well as the more detailed list of SBA research questions, interviewees felt that the study addressed the most important issues. Most respondents expressed greater interest in the pension area than the health benefits area.

Interviewees were very responsive to the proposed research strategy of combining analyses of large data bases, with in-person and telephone interviews and on-site case studies. Most respondents acknowledged the lack of current and reliable information on benefit plans in small firms--noting that, in part, the small business perspective was often underrepresented in legislative hearings in the benefits area because of a lack of data and analysis. Interviewees felt that the small sample, purposive interviews and case-studies offered a valuable and effective research method for generating much-needed data about formation and administration of benefit plans. In addition, they felt that this approach might get at the "nuts and bolts" problems faced by small firms. Finally, interviewees supported the staged nature of the data collection and analysis plan--feeling that it was valuable to develop successively more penetrating analysis by building upon prior increments of descriptive analysis.

Respondents expressed interest in both the content and form of the study's research products. Some indicated that products should not be "overly academic". Others felt that products should be closely linked to the development of policy positions on future legislative actions in the employee benefits area. Finally, other respondents hoped that the final report would give detailed treatment to the case studies and accurately reflect the concerns and problems for the small businesses in forming/changing/administering benefit plans.

Exhibit E-1 provides a summary of the Needs Specification interviews. The table briefly summarizes, by respondent, the major information needs and anticipated uses of the information generated from this project, as well as other comments that pertain to the scope, methodology or study questions of this project. For example, an interviewee representing the congressional perspective, felt that data and analysis were needed on the effect of a "second round" of ERISA legislation on small business decisions to provide pension benefits. This respondent intended to use products of this study to assist in the review of proposed or recent legislation that was likely to affect employee benefit regulations.

For purposes of assessing need, we divided interviews into three major perspectives: congressional staff, representatives of small business interests, and independent research experts in the area of employee benefits. Across these three perspectives, we found general agreement over the need for data development and analysis in the major research topic areas of this study (i.e., coverage, characteristics, etc.). There was, however, considerable variation in the specific issues mentioned by respondents in the three groups.

The three respondents that formed the "congressional" perspective seemed to be most interested in the direct effects of recent and pending legislation, benefit plan costs, administrative practices and factors affecting the cost of plans. Interest in the extent of coverage and benefit plan characteristics tended to be expressed in terms of how possible legislative initiatives might affect these two issues. Respondents representing the congressional perspective identified five issue areas where research activities and products should be targeted:

- Analysis of the impact of recent legislative changes in the rate of formation/termination of private pension plans in small firms is needed. Some of the examples of legislation or regulations were the following: effects of "prohibited transactions", overall effects of MEPPA, and impacts of "top heavy" rules.

- Analysis of the likely impacts of proposed changes in pension legislation on the formation/termination and costs of operating private pension plans in smaller firms is needed. Some examples include: effects of further increase in the PBGC premium; impacts of relaxation of the "prudent man" investment restrictions; impacts of changes in "portability" rules; and effects of rigorous enforcement of non-discrimination rules in the pension benefits area.

- More extensive data collection and analysis on the costs of formation/ongoing operation of pension plans within smaller firms, particularly start-up costs and regulatory costs, is needed.

- Better understanding of the circumstances and problems faced by small businessmen in setting up and administering employee benefit plans based on actual experiences is needed. This would include: steps a small firm went through in establishing a plan, problems faced at different stages, general understanding of federal regulations affecting pensions, and day-to-day administrative costs and practices in managing a private pension plan within a small firm.

- Data and analysis on the likely impact of a new legislative proposal that would tax (some part) of employee health care benefits is needed. This would include: reaction of smaller firms to such legislation, methods by which such an initiative could be administered, effects on the level of coverage of health care benefits, employee reactions to such a tax and whether they would reduce the level of coverage sought, and types of firms/employees most hurt by such legislation.

As might be expected, the three interviewees representing the "small business interest" perspective were particularly interested in the ways in which regulation affected the decisions of small firms to offer benefit plans. There was particular interest among this group over the costs associated with different types of benefit packages. There was also considerable interest in the types of plans and level of coverage currently offered, as well as in the possible legislative alternatives that would improve incentives for smaller firms to offer benefit plans. Respondents in this group identified the following issues as representing important information needs:

- Analysis of the effect of recent legislative changes on the formation/termination of pension plan is needed.
- Information and analysis of the characteristics and types of pension benefits selected by firms is needed. This would include: information about the range of pension plans offered by accounting and legal firms, ways employers use employee benefits to attract and hold workers, and stages firms go through in establishing benefit packages for employees.
- Data and analysis concerning the costs of establishing employee benefits is needed. This would include: legal and accounting fees associated with the formation of benefits, and paperwork costs involved in forming/administering plans.
- Data, analysis and recommendations concerning the proposed legislation that would tax employee health care benefits is needed. This would include: costs of such taxation to employees of smaller firms, whether firms would bear any of the costs of the taxation, whether firms would be less likely to offer such benefits.

- Data on the relative availability and costs of health care benefits for smaller firms compared to larger firms is needed. This would include: how much more smaller firms pay for a given package of health care benefits (because of adverse "experience rating"), types of health care benefit packages that are not available to small firms, and recommendations concerning the options available to small firms in providing health benefits.

Similar to the representatives of small business interests, the respondents from the "independent expert" viewpoint were interested in the factors that seemed to most effect the decision of small businesses to offer pension and health care benefits to employees. These experts, as might be expected, were concerned over the types and quality of data that would be produced under the interviews and case studies. Several information need issue areas were identified by this group:

- Analysis of the most important factors in the decisions of small firms to offer pension benefits to employees is needed. For example, this analysis should investigate: the basic decision calculus that the small firm goes through in establishing benefits; basic incentives (e.g., tax advantages) that small businesses react to in setting up benefits; and major changes that occur in the type and extent of coverage over the lifetime of the firm.

- Data and analysis of the linkage between certain characteristics of the firm and the selection of a particular mix of employee benefits is needed. For example, this analysis might examine the way in which age structure of employees affects the type of pension benefits selected or analyze the way in which product line or profitability affect the type of benefits chosen.

- Data on the costs of offering different types of employee benefits is needed. For example, these data should include information about the types and costs of "packages" used to establish employee benefits. In addition, a close examination should be made of the higher costs of providing comparable health benefit packages in smaller firms.

- Data and analysis on the effects of recent legislative changes on the costs of forming/administering employee benefit plans in small firms is needed. For example, cost impacts of ERISA should be analyzed.

EXHIBIT E-1

INFORMATION NEEDS, ANTICIPATED USES AND OTHER COMMENTS FROM NEEDS SPECIFICATION INTERVIEWS

Congressional Perspective

Information Needed	Anticipated Use of Information	Comments Relating to Study Scope, Method or Products
Impact of 'second round' of ERISA legislation on small business decisions to offer pension benefits.	Intended to use data and analysis to assist in the review of proposed or recent legislation affecting employee benefits regulation.	Noted that smaller business interests were generally underrepresented during Congressional testimony on pension/health care benefits.
Effects of further increases in PBGC premium on private pension plans in smaller businesses; impact of a "risk related" premium on small business pension plans.		Doesn't expect legislation which would affect: the level of paperwork in administering pensions, mandatory private pensions in smaller firms, or special government administering agency for private pensions.
Types of benefit plans offered by different classes/types of small businesses.		
Factors effecting the establishment Employee Stock Ownership Plans (ESOPs); specific reasons that ESOPs are not being set up.		
Impacts of relaxation of "prudent man" investment restrictions; effects of relaxing restrictions on pension investment in mortgages.		
Effects on taxing employee health benefits on provision of such benefits.		
Breakdown of costs of formation/ ongoing management of health/ pension benefits within small firms.		

EXHIBIT E-1
(Continued)

Congressional Perspective

Information Needed	Anticipated Use of Information	Comments Relating to Study Scope, Method or Products
"Nuts and bolts" problems faced by small businesses in setting up and administering employee benefit plans.	Intended to use information to guide committees review of legislative proposals and recent changes in legislation.	Strongly supported the use of case studies to probe "nuts and bolts" issues and problems faced by small employers with establishing and maintaining employee benefits.
Effects of "prohibited transactions" on smaller plans.	Anticipates some legislative action on ERISA in the Spring 1983.	Stressed importance of talking with actuarial firms to gain clearer understanding of costs associated with formation of pension benefit plans in smaller firms.
Effects of the MEPPA (i.e., "Multiemployer Bill") on smaller businesses.		Doesn't expect increase in PBGC premium to have much of an effect on small business pension plans.
Effects on taxing employee health care benefits on provision of such benefits within small firms.		Identified small business firm's "unawareness" of changes in pension regulations as a key problem.
		Doesn't feel that an "academic" study would be very helpful, particularly within legislative hearings.

EXHIBIT E-1
(Continued)

Congressional Perspective

Information Needed	Anticipated Use of Information	Comments Relating to Study Scope, Method or Products
Effects of changes in social security "integration" rules.	Intended to use information to guide committee's review of legislative proposals and recent changes in regulations.	"Integration" proposals most likely fringe benefit tax proposal to be addressed in 1983.
Effects of changes in social security policy on pension plans, DRA.		Expected huge ramifications on provision of pension plans if "flat tax" legislation was adopted (e.g., it would lead to removal of key tax advantages currently in existence).
Effects of "top heavy" rules in TEFRA on the formation of private pensions in small businesses. Impact of changes in "portability" rules on pensions in small businesses.		Anticipated difficult administrative problems in attempting to tax health care benefits.
Effects of taxing employee health benefits on the provision of such benefits.		Doesn't expect any legislation effecting level of paperwork in meeting government regulations.
Effects of "non-discrimination" laws on the types and characteristics of private pensions in small firms.		
Impacts of "women's issues" on the characteristics and formation of pensions in small firms (e.g., vesting requirements, survivor benefits, divorcee benefits).		
Effects of increases in payroll tax on the provision of pension benefits in small firms.		

EXHIBIT E-1
(Continued)

Independent Expert Perspective

Information Needed	Anticipated Use of Information	Comments Relating to Study Scope, Method or Products
Analysis of stages and "time horizons" in the establishment of employee benefits (over lifetime of the small firm). Linkage between characteristics of firms (particularly age structure of workforce, firm size, etc.) and the pattern of employee benefits. Assessment of incentives in current legislation for extending benefits to employees. Data on the relative costs of health care benefits for large firms versus small firms. Effects of the "top heavy" rule on the formation of private pension plans in small firms. The "packaging" of employee benefit plans and impact on costs of these plans.	Intended to use information generated in this study to better understand trends in the formation of employee benefits in smaller firms and to shape policy recommendations.	Future real private pension plan growth is likely to occur within small firms, if it occurs at all (i.e., expanded coverage of employee is likely to occur within small firms). Important to use careful selection process when doing the interviews and case studies of firms (difficult to get a representative sample of smaller firms). Doesn't expect increase in the PBGC premium to have much impact on small firms. Recent work in the area of health care benefits indicates that an overwhelming majority of small firms offer health care coverage. Important issues that will be examined in the near future: single employer legislation, "integration" of pension benefits with Social Security benefits, and vesting requirements.

EXHIBIT E-1
(Continued)

Independent Expert Perspective

Information Needed	Anticipated Use of Information	Comments Relating to Study Scope, Method or Products
Cost data and analysis on establishing/maintaining private pensions in small firms.	Intended to use study to extend knowledge of the basic issues confronting small businesses in forming/maintaining employee benefits.	Stresses importance of discussions with actuarial cost accountants to develop better information about costs of establishing/maintaining private pensions in small firms.
Analysis of the stages small firms go through in establishing a given set of employee benefits.		Expects that the issue of "portability" of credits in private pension plans will become increasingly important.
Effects of ERISA on costs of forming pension plans in small firms.		Limits on medicare coverage in future may affect health care plans/pension plans in smaller firms.
Types of employees that choose to participate in pension/health care plans offered by small firms.		
Identification of gaps in health care coverage..		
Data on the formation/cutting back of health care benefits in small firms.		

EXHIBIT E-1
(Continued)

Independent Expert Perspective

Information Needed	Anticipated Use of Information	Comments Relating to Study Scope, Method or Products
Start-up costs involved in formation of a private pension plan.	Intended to use data and analysis generated by this study to shape basic policy recommendations of NBRI concerning employee benefits in small businesses.	Observed that it is very difficult to quantify regulatory and paperwork costs.
Impacts of type and age of business firm on the selection of a pension plan (e.g., do small businesses tend to start with a profit sharing plan?).		Noted that when NFIB surveyed their members that they made instruments short (1-2 pages), readable, and asked for numbers. Warned that the average small businessman is unlikely to be very knowledgeable about pension regulations or the specifics of his own plan.
Types of paperwork costs borne by smaller firms in administering employee benefits plans.		
Types of employers that use their employee benefits to attract workforce.		Noted the importance of talking to actuarial experts in tracking costs of employee benefits.
Impacts of ERISA on the formation/termination of pension plans in small firms.		Estimated that among their members that there had been a slight growth in recent year in the number of private pension plans (estimated that about 30 percent currently had some form of pension coverage).
Impact of taxation of health care benefits on the offering of such plans in small firms.		Noted that $23 billion is currently deducted for employee health care benefits.
Data on the cost and availability of health care benefit plans for small firms.		Anticipated legislative action on the "integration" issue in near future.

EXHIBIT E-1
(Continued)

Small Business Perspective

Information Needed	Anticipated Use of Information	Comments Relating to Study Scope, Method or Products
Impacts of taxing health benefits on the provision of such benefits to employees.	Intended to use data and analysis to shape policy positions on various pension/health care proposals and gain support for legislative actions beneficial to smaller businesses.	In setting up health care plans small firms are typically at a relative disadvantage to large firms both in terms of availability and costs of plans. This is in large part due to "experience rating".
Effects of ERISA on the formation/termination of pension plans within small firms.		His organization planned to fight any legislation which would levy a tax on employee health benefits.
Extent of ERISA on the formation/termination of pension plans within small firms vs. large firms; identification of policies that would encourage the formation of pension/health care plans in small firms without such plans.		Estimated that far less than half of the 4000 member of his business organization offered pension benefits; estimated that nearly 90 percent of his members offered some type of health benefit.
		Felt that there was considerably lower pension plan formation in small firms since ERISA.

EXHIBIT E-1
(Continued)

Small Business Perspective

Information Needed	Anticipated Use of Information	Comments Relating to Study Scope, Method or Products
Data on impact of ERISA on the termination/formation of pension plans.	Intended to use study to develop and shape policy positions on issues affecting employee benefits in small firms.	Estimated that 80-90 percent of his members (1400-1500) currently had some form of health care benefits.
Data on legal and accounting fees associated with formation of employee benefits.		Noted that when a firm reached about 100 employees that it was possible to sustain a health benefit package at a good rate.
Impact of taxing health benefits on the provision of such benefits in small firms.		
New types of pension plans offered by accounting/legal firms.		

EXHIBIT E-1
(Continued)

Small Business Perspective

Information Needed	Anticipated Use of Information	Comments Relating to Study Scope, Method or Products
Effect of TEFRA legislation on formation of pension plans in small businesses, particularly of "top heavy" restrictions.	Intended to use data and analysis to better understand basic factors effecting small business decisions in the employee benefits area.	Anticipates that small firms will end up bearing much of the costs of any tax on employee health benefits.
Analysis of small business firms understanding of federal regulations governing employee benefit plans.		Expects that small firms will experience problems in meeting TEFRA's "top heavy" requirement, particularly as a firm's workforce experiences transitions.
Types and level of coverage within small firms.		Estimates that 40% of SBANE's membership (a small business organization located in New England) offered pension benefits and about 85% offered health care benefits.
Impacts of taxing health care benefits on the willingness of smaller firms to offer such benefits.		

Mr. HEFTEL. Our next panel is Alicia H. Munnell, vice president and economist, Federal Reserve Bank of Boston; Joseph Minarik, senior research associate, the Urban Institute; Kenneth Simonson, President's Commission on Industrial Competitiveness; Stephen Woodbury, senior research economists, Upjohn Institute; Gail Wilensky, director, Center for Health Affairs and vice president, Domestic Division.

Though there is no rhyme or reason to the order in which I have your names, so that at least I will be able to identify you by the time you have testified, why don't we have you testify in the order that you are on the panel sheet, starting with Alicia H. Munnell, vice president, Federal Reserve Bank of Boston.

STATEMENT OF ALICIA H. MUNNELL, SENIOR VICE PRESIDENT AND DIRECTOR OF RESEARCH, FEDERAL RESERVE BANK OF BOSTON

Ms. MUNNELL. Thank you, Mr. Chairman, I am actually now senior vice president and director of research of the Federal——

Mr. HEFTEL. See what a difference a day can make?

Ms. MUNNELL. I appear today on my own behalf. My views do not necessarily represent the position of the Boston Fed or the Federal Reserve System.

I share the concern of the members of the subcommittees about the growth in employer-provided fringe benefits and today would like to argue for two major changes: the establishment of an overall limit on the share of compensation that can be received tax free under the Federal personal income tax; and the full inclusion of employer-provided fringe benefits in the payroll tax base for FICA taxes.

In order to establish the case for reform, I will focus on four major issues: one, the impact of the growth in fringe benefits on the personal income and payroll tax bases and on the long run costs of the Social Security Program; two, the impact of these benefits on the equity of the tax structure; three, the outlook for the future growth of fringe benefits; and four, the practicality of the proposed reforms.

Between 1950 and 1984, employer-sponsored fringe benefits, which allow employees either to avoid the payment of income and payroll taxes altogether or to profit from the deferral of income tax payments until retirement, have increased from 2.6 to 10.4 percent of total compensation. These benefits, which consist primarily of pensions, group health, and group life insurance, have significantly eroded both the income and payroll tax bases and raised the long run costs of the Social Security Program.

In terms of income tax calculations for 1984 indicate that the net revenue loss for the three primary statutory benefits—group health and life insurance and pensions—amounts to almost $70 billion, which represents approximately 22 percent of personal income tax receipts in this year. In other words, personal income tax revenues would have been almost 22 percent higher if employee benefits were taxed in the same manner as wage and salary income, or tax rates could have been reduced approximately 18 percent and still have provided the same revenue.

Exclusions from the payroll tax base have never been considered "tax expenditures," since the Treasury and the Congressional Budget Office assume any reduction in contributions is reflected in lower benefits. Nevertheless, since the benefit reductions associated with a decline in payroll tax contributions do not appear for some time, it is useful to consider the immediate revenue loss associated with excluding fringe benefits from the payroll tax base.

Calculations indicate that 1984 payroll tax receipts would have been $25 billion higher if employee benefits were included in the payroll tax base. Alternatively, the 1984 Social Security payroll tax rate for the retirement and disability portion of the program could have been lowered from 5.7 percent each for the employer and employee to 5.2 percent, without any reduction in 1984 revenues.

Of course in the long run, broadening the payroll tax base to include employer-provided fringes will mean higher future Social Security benefits. The important point for our discussion, however, is that the resulting benefit increases will be less than the additional tax receipts produced by including fringes in the tax base. The reason for this phenomenon is the weighted benefit formula, which provides that a smaller percentage of wages are replaced at higher earnings levels than at lower ones. Since most of the increase in the payroll tax base would occur at higher earnings levels, benefit payments would not be increased proportionately. Thus, the long-range costs of the program would be reduced by including employer-provided fringes in the payroll tax base.

Preliminary estimates by the Social Security actuaries indicate that if the ratio of employer-provided fringe benefits to total compensation stabilized at current levels, rather than continuing to increase as projected in the official cost estimates, the projected payroll tax rate required to finance the retirement and disability portions of the Social Security Program over the next 75 years could be reduced by roughly 0.4 percentage points.

That is instead of requiring revenues equal to 13.0 percent of taxable payrolls to cover promised benefits, the system could be financed for the next 75 years at an average cost of 12.6 percent. Alternatively, including employer-provided fringe benefits in full in the payroll tax base would reduce long run costs by 0.6 percent of taxable payrolls; that is, from 13.0 percent to 12.4 percent.

Including fringe benefits in the income and payroll tax bases not only would increase revenues, but also would improve the equity of the tax structure. In the United States, it has generally been agreed that income should be defined broadly for the purposes of levying taxes, since this approach insures that taxpayers with equal economic resources are assessed equal amounts of taxes and those with different capabilities are assessed different amounts.

By excluding the value of fringe benefits from the tax base or deferring taxation until the recipient faces lower marginal tax rates, the current provisions create two types of inequities. First, excluding a major component of income from the tax base means that two individuals, who are equally well off in an economic sense, will pay different amounts of income and payroll tax over their lifetimes.

Second, the exclusion has an adverse effect on the distribution of income. Fringe benefits are concentrated among higher paid employees and under the income tax, although not the payroll tax, the value of exclusion and deferral increases with a worker's marginal tax rate. Yet, all taxpayers must pay higher taxes to compensate for the favorable tax treatment accorded employee benefits.

If the generous provisions associated with the fringe benefits are allowed to continue for the growing array of new benefits, the payroll and income tax bases will be reduced to the point where they can no longer be considered even approximations of ability to pay. What then is the outlook for the future of fringe benefits?

The social security trustees project that the ratio of benefits to total compensation will increase by 0.3 percent annually. A decade ago, such a forecast might have been viewed as somewhat high, since the work force appeared fairly well saturated with the traditional statutory benefits. Recent developments, however, reveal considerable interest on the part of both the employee and the employer in expanding the role of nontaxable compensation and a willingness on the part of Congress to provide new mechanisms with which to accomplish this goal.

The extension of statutory benefits began in 1974 with incentives for employers to establish employee stock ownership plans [ESOP's] for their employees. The next step in the expansion was a substantial increase in the list of services that could be provided tax free by employers for their employees. These include prepaid legal services, employer-provided transporation by commuter van, educational assistance, and dependent care assistance.

A third innovation in employee benefit provision was the encouragement of so-called cafeteria plans that allow employees to select from a menu of benefits and salary packages with a variety of health, vacation, insurance, retirement and other benefits. The same legislation also authorized so-called section 401(k) plans that allow employees to reduce their salary by up to 15 percent of compensation and invest the money tax free in a special account.

Finally, the most recent relevant legislation, the Deficit Reduction Act of 1984, awarded statutory standing to a list of benefits that had generally been viewed as tax-exempt by the public. Although early attempts were made to tighten up the rules for the taxation of these nonstatutory benefits, the final legislation essentially codified existing employer practices. In short, fringe benefits will probably constitute an ever increasing portion of total compensation.

Given that the growth in fringe benefits is likely to continue, the question then becomes what should be done. Although Congress and the Treasury have expressed concern about the trend towards workers taking more compensation in tax-free benefits, Congress has so far limited reforms to relatively minor actions, such as curtailing benefit practices that are clearly aimed at tax avoidance.

I think that the time has come for more comprehensive approach to tax reform, and that the reform should be logical and consistent with the principles of the nation's tax policy.

Any economist will tell you that, for purposes of tax equity, the theoretically pure solution would be to establish a comprehensive definition of compensation for both income and payroll tax purposes. Under such definition, the value of the employer's contributions for health and life insurance and the increase in the value of accrued pension benefits would be included in the employee's income. Employer contributions for dependent care, van pooling and educational assistance would also be included in income, and salary reduction schemes, such as 401(k) plans, would be repealed.

While such a reform would not be extraordinarily difficult to implement for either the payroll or income tax, such a dramatic change might have undesirable economic consequences. The basic statutory benefits have been awarded preferential status under the tax code precisely because it was deemed desirable to encourage certain types of activities.

Almost everyone agrees that favorable tax treatment has contributed significantly to the expansion of pension, health, and life insurance plans. On the other hand, the existence of fringe benefits cannot be attributed to tax policy alone. Pension plans, for example, existed long before the income tax, reflecting employers' needs for an impersonal and egalitarian mechanism to retire super annuated workers. However, because the precise role played by tax preferences in the growth of the basic statutory benefits is not known, it would probably be unwise to dramatically alter the current treatment and include the full value of these benefits in the tax base for income tax purposes. On the other hand, it does seem both desirable and feasible to include all fringe benefits in the definition of taxable wages under the payroll tax.

A precedent already exists in the taxation of 401(k) plans for treating fringe benefits differently under the income and payroll taxes. The codification of the Rowan decision provides that an exclusion of income for income withholding shall not affect the treatment of income for payroll tax purposes. As a result of the 1983 social security amendments, employee contributions to 401(k) plans are included in the payroll tax base even though they are deductible under the income tax.

The 401(k) experience also seems to indicate that the application of the payroll tax alone to an employee benefit does not have a seriously adverse impact on its adoption and growth. Recent surveys indicate a dramatic expansion of 401(k) plans. Not only are they continuing to expand among large companies, but are increasingly being adopted by middle-sized firms, which is surprising since innovations in benefits generally take some time to trickle down from the largest employers.

Nevertheless, a recent survey indicates that half of the medium-sized firms who responded to the survey, 256 firms in 38 States, said they were taking positive action toward adopting 401(k) plans or already have such a plan in place.

In short, it is theoretically desirable, administratively practical, and economically feasible to include all fringe benefits in the payroll tax base. This change will increase short-term revenues by roughly $30 billion per year, and allow Congress to reduce the scheduled 1988 and 1990 payroll tax increases by more than half and reduce the longrun costs of the system by 0.6 percent of taxable payrolls. Moreover, the applicability of the employer's share of the payroll tax to employee benefits removes the incentive for the employer as well as the employee to prefer noncash payments.

While identical treatment of fringe benefits under the income tax may not be desirable, some reforms are obviously necessary in order to avoid becoming a society where workers receive half their compensation in wages and half in fringes. The most obvious compromise is to place an overall limit on the amount of fringe benefits—including pensions—that workers can receive tax free under the income tax.

Setting such a limit must necessarily involve some degree of arbitrariness, but would restrain the erosion of the tax base without subjecting most of the work force to an immediate increase in their tax liability. If a single number had to be selected, it should probably be slightly above the current benefits to compensation ratio of 12.5 percent that prevails in the manufacturing sector. Perhaps, 15 percent of total compensation might be reasonable. A preferable approach, however, would be to allow a generous amount of nontaxable benefits as a percentage of compensation at lower income levels and reduce the percentage as income increases. For example, nontaxable benefits could account for 25 percent of the first $40,000 of compensation, 15 percent of the next $40,000, and 5 percent of any compensation over $80,000.

Thus, my recommendation is twofold: To tax fringe benefits in full under the payroll tax and to establish an aggregate progressive limit on tax free or tax deferred fringes under the income tax.

[The prepared statement follows:]

STATEMENT OF ALICIA H. MUNNELL,[1] SENIOR VICE PRESIDENT AND DIRECTOR OF RESEARCH, FEDERAL RESERVE BANK OF BOSTON

THE ECONOMIC EFFECTS OF THE GROWTH OF EMPLOYER-PROVIDED FRINGE BENEFITS

My name is Alicia Munnell. I am Senior Vice President and Director of Research at the Federal Reserve Bank of Boston. I appear today on my own behalf; my views do not necessarily represent the position of the Boston Fed or the Federal Reserve System.

I share the concern of the members of the subcommittees about the growth in employer-provided fringe benefits and today would like to argue for two major changes:

(1) The establishment of an overall limit on the share of compensation that can be received tax free under the federal personal income tax; and

(2) The full inclusion of employer-provided fringe benefits in the payroll tax base for FICA and FUTA taxes.

In order to establish the case for reform, my testimony will focus on four major issues: (1) the impact of the growth in fringe benefits on the personal income and payroll tax bases and on the long-run costs of the social security program; (2) the impact of these benefits on the equity of the tax structure; (3) the outlook for the future growth of fringe benefits; and (4) the practicality of the proposed reforms.

I. The growth of employee benefits and its impact on the tax base

Between 1950 and 1984, employer-sponsored fringe benefits, which allow employees either to avoid the payment of income and payroll taxes altogether or to profit from the deferral of income tax payments until retirement, have increased from 2.6 to 10.4 percent of total compensation (see Table 1). These benefits, which consist primarily of pensions, group health, and group life insurance, have significantly eroded both the income and payroll tax bases and raised the long-run costs of the social security program.

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[1] The views expressed are solely those of the author and do not necessarily reflect the official position of the Federal Reserve Bank of Boston or the Federal Reserve System.

TABLE 1.—EMPLOYER-PROVIDED FRINGE BENEFITS AS A PERCENT OF TOTAL COMPENSATION, 1950–84

[Percent]

Employer-provided benefit	1950	1960	1970	1980	1984[1]
Group health insurance	0.5	1.1	2.0	3.1	4.2
Group life insurance	.2	.4	.5	.4	.4
Pension and profit sharing:					
Private pensions	1.1	1.6	2.1	3.5	3.7
Government pensions[2]	.7	1.2	1.3	1.8	2.0
Other	.1	.1	.1	.1	.1
Total employer-provided benefits	2.6	4.4	6.0	8.9	10.4

[1] Projections for total compensation were obtained from Data Resources, Inc. Percentages were estimated by author assuming rate of growth from 1983–1984 was the same as that from 1980–83.

[2] Includes Federal Civilian Retirement System and State and local retirement systems; military pensions are not included. In 1971, the Treasury Department began to transfer funds into the Federal Civilian Retirement System to pay the interest on unfunded liability and to amortize over a 30-year period any increase in the unfunded liability. Since these transfers are not included in the National Income and Product Accounts, we did not include them in this table in order to maintain consistency. This results, however, in an understatement of the contributions to Government pensions relative to private pensions and profit sharing.

Sources: Chamber of Commerce of the United States, "Employee Benefits Historical Data, 1951–1979" (Washington, D.C., 1981) and "Employee Benefits, 1982" (Washington, D.C., 1983); "The National Income and Product Accounts, 1929–76, Statistical Tables," Supplement to the "Survey of Current Business," vol. 61 (September 1981), Tables 1.11, 2.1, 6.15; "National Income and Product Accounts, 1976–79," Special Supplement to the "Survey of Current Business," vol. 61 (July 1981), Tables 1.11, 2.1, 6.15 and "Survey of Current Business," vol. 63 (July 1983), Tables, 1.11, 2.1, 6.15.

The impact of employee benefits on the income tax base

The effect of the exclusion of group health and life insurance on the income tax base and on personal income tax receipts is straightforward. Gross income is lowered by the amount of the contributions and taxes are reduced by an amount equal to the relevant marginal income tax rate times the excluded contributions. This reduction in receipts, commonly referred to as a "tax expenditure," is calculated annually by the Treasury Department and included as a Special Analysis to the Budget document.

The impact of the favorable tax treatment of pensions on the income tax base is somewhat more complicated, since this employee benefit involves the deferral of taxation rather than complete avoidance. For cash-based budget purposes, the revenue effect in a given year is the net of two offsetting parts—the revenue loss from exempting employer contributions and pension fund earnings from current taxation, and the revenue gain from currently taxing private pension benefits.

In terms of the income tax calculations for 1984 indicate that the net revenue loss for the three primary statutory benefits—group health and life insurance and pensions—amounts to almost $70 billion, which represents approximately 22 percent of personal income tax receipts in this year (see Table 2). In other words, personal income tax revenues would have been almost 22 percent higher if employee benefits were taxed in the same manner as wage and salary income, or tax rates could have been reduced approximately 18 percent and still have provided the same revenue.

TABLE 2.—BENEFITS, 1950–84

[Dollars in billions]

Benefit[1]	1950	1960	1970	1980	1984[2]
Group health insurance: Exclusion of employer contributions	−$0.2	−$0.8	−$2.8	−$12.9	−$22.9
Group life insurance: Exclusion of employer contributions:	−.1	−.2	−.7	−1.7	−2.2
Pensions and profit sharing:					
Private plans:					
Exclusion of employer contributions	−.4	−1.1	−2.8	−14.1	−20.2
Exclusion of fund earnings[3]	(4)	−.4	−2.3	−13.5	−17.6
Inclusion of current benefits	(4)	+.2	+.8	+4.6	+8.8
Net revenue effect	−.4	−1.3	−4.3	−23.0	29.0

TABLE 2.—BENEFITS, 1950–84—Continued

[Dollars in billions]

Benefit [1]	1950	1960	1970	1980	1984 [2]
Government plans: [5]					
Exclusion of employer contributions	−.2	−.6	−1.7	−6.9	−10.6
Exclusion of fund earnings [3]	(4)	−.2	−1.2	−8.1	−11.9
Inclusion of current benefits	+.1	+.2	+.7	+3.3	+6.8
Net revenue effect	−.1	−.6	−2.2	−11.7	−15.7
Total revenue effect	−.8	−2.9	−10.0	−49.3	−69.8
ADDENDUM					
Revenue loss as a percent of personal income tax receipts	4.0	6.9	11.3	19.7	21.7

[1] Revenue loss calculated by author using average marginal tax rates developed by Barro and Sahasakul—23 percent in 1950, 1960 and 1970 and 26 percent for 1980 and 1984. Revenue gain estimated assuming retirees face a marginal tax rate equal to one-half the average marginal rate.

[2] Contributions, assets and benefits projected by author assuming rate of growth from 1983–84 was the same as that from 1980–83.

[3] Fund earnings calculated by author using asset information from "Flow of Funds Account" and assuming a rate of return on those assets equal to the rate earned on 3-month Treasuries in that year.

[4] Less than $0.05 billion.

[5] Includes Federal Civilian Retirement System and state and local retirement systems; the military retirement plan is not included.

Sources: Board of Governors of the Federal Reserve System, "Flow of Funds Accounts, 1949–1978: Annual Total Flows and Year-End Assets and Liabilities" (1979) and "Assets and Liabilities Outstanding, 1959–1982" (1983); "The National Income and Product Accounts, 1929–76 Statistical Tables," Supplement to the "Survey of Current Business," vol. 61 (September 1981), "National Income and Product Accounts, 1976–79," Special Supplement to the "Survey of Current Business," vol. 61 (July 1981), and "Survey of Current Business," vol. 63 (July 1983), Tables 1.11, 3.4, 6.15 and 8.4; Robert J. Barro and Chaipat Sahasakul, "Measuring the Average Marginal Tax Rate from the Individual Income Tax," NBER Working Paper No. 1060 (January 1983); Council of Economic Advisors, "Economic Report of the President" (Washington, D.C., 1984); American Council of Life Insurance, "Pension Facts 1982, 1983 Update" (Washington, DC, 1984).

The impact of employee benefits on the payroll tax base

Exclusions from the payroll tax base have never been considered "tax expenditures," since it has been generally assumed that any increase in contributions is reflected in higher benefits. Nevertheless, since the benefit increases associated with an increase in payroll tax contributions do not appear for some time, it is useful to consider the immediate revenue loss associated with excluding fringe benefits from the payroll tax base. This calculation differs from that performed for the income tax in two respects. First, employer contributions for all employee benefits represent permanent reductions in the payroll tax base; even contributions to pension plans escape tax completely, since no payroll tax is levied on pension benefits in retirement. Second, revenue loss occurs on both the employees' and employers' side of the transaction, since neither party is required to pay taxes on exempt employer-provided benefits. The calculations for 1984 indicate that payroll tax receipts would have been $25 billion higher if employee benefits were included in the payroll tax base (see Table 3). Alternatively, the 1984 social security payroll tax rate for the retirement and disability portion of the program could have been lowered from 5.7 percent each for the employer and employee to 5.2 percent, without any reduction in 1984 revenues.

Of course in the long-run, broadening the payroll tax base to include employer provided fringes will mean higher future social security benefits. The important point for our discussion, however, is that the resulting benefit increases will be less than the additional tax receipts produced by including fringes in the tax base. The reason for this phenomenon is the weighted benefit formula, which provides that a smaller percentage of wages are replaced at higher earnings levels than at lower ones. Since most of the increase in the payroll tax base would occur at higher earnings levels, benefit payments would not be increased proportionately. Thus, the long-range costs of the program would be reduced by including employer provided fringes in the payroll tax base.

TABLE 3.—IMMEDIATE REVENUE EFFECTS UNDER THE PAYROLL TAX FROM EMPLOYER-PROVIDED BENEFITS, 1950–84

[Dollars in billions]

Benefits	1950	1960	1970	1980	1984 [1]
Group health insurance	([2])	−$0.2	−$0.9	−$5.4	−$10.4
Group life insurance	([2])	−0.1	−0.3	−0.7	−1.0
Pension and profit sharing:					
Private pensions	−0.1	−0.2	−0.9	−5.9	−9.0
Government pensions	([2])	−0.2	−0.6	−2.9	−4.7
Total revenue effect	−0.1	−0.7	−2.7	−14.9	−25.1
ADDENDUM					
Revenue loss as percent of payroll tax receipts	2.2	3.9	6.0	10.6	10.9

[1] Contributions projected by author (see table 1, footnote 1).

[2] Less than $0.5 billion.

Sources: "Social Security Bulletin," "Annual Statistical Supplement, 1983 (GPO, 1983), pp. 72, 200; 1984 Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds" (GPO, 1984); "The National Income and Product Accounts, 1929–76 Statistical Tables," Supplement to the Survey of Current Business," vol. 61 (September 1981); "National Income and Product Accounts, 1976–79," vol. 61 (July 1981); "Revised Estimates of National Income and Product Accounts," vol. 63 (July 1983), table 8.4; and Office of the Actuary, Harry C. Ballantyne," Long-Range Projections of Social Security Trust Fund Operations in Dollars," actuarial note 120 (May 1984).

Preliminary estimates by the social security actuaries indicates that if the ratio of employer-provided fringe benefits to total compensation stabilized at current levels, rather than continuing to increase as projected in the official cost estimates, the projected payroll tax rate required to finance the retirement and disability portions of the social security program over the next 75 years could be reduced by roughly 0.4 percentage points. That is, instead of requiring revenue equal to 13.0 percent of taxable payrolls to cover promised benefits, the system could be financed for the next 75 years at an average cost of 12.6 percent. Alternatively, including employer-provided fringe benefits in full in the payroll tax base would reduce long-run costs by 0.6 percent of taxable payrolls—that is, from 13.0 percent to 12.4 percent.

II. The impact of fringe benefits on tax equity

Including fringe benefits in the income and payroll tax bases not only would increase revenues, but also would improve the equity of the tax structure. In the United States, it has generally been agreed that income should be defined broadly for the purposes of levying taxes, since this approach insures that taxpayers with equal economic resources are assessed equal amounts of taxes and those with different capabilities are assessed different amounts.

By excluding the value of fringe benefits from the tax base or deferring taxation until the recipient faces lower marginal tax rates, the current provisions create two types of inequities. First, excluding a major component of income from the tax base means that two individuals, who are equally well off in an economic sense, will pay different amounts of income and payroll tax over their lifetimes. Second, the exclusion has an adverse effect on the distribution of income. Fringe benefits ar concentrated among higher paid employees and under the income tax, although not the payroll tax, the value of exclusion and deferral increases with a worker's marginal tax rate (see Table 4). Yet, all taxpayers must pay higher taxes to compensate for the favorable tax retirement accorded employee benefits.

TABLE 4.—REVENUE EFFECTS [1] OF TAX EXPENDITURES, BY ADJUSTED GROSS INCOME CLASS, 1983

Adjusted gross income class (thousands)	Total returns filed		Tax expenditures					
			Employer pension plans		Health insurance		Life insurance	
	Number	Cumulative percent distribution	Amount (millions)	Cumulative percent distribution [2]	Amount (millions)	Cumulative percent distribution [2]	Amount (millions)	Cumulative percent distribution [2]
Less than $10	34,366	100.0	−$1.1	100.0	−$1.3	100.0	−$0.1	100.0
$10 to $15	13,457	63.3	−1.6	96.0	−1.7	93.4	−.1	95.5
$15 to $20	10,936	48.9	−2.2	90.4	−2.1	84.7	−.2	89.4

TABLE 4.—REVENUE EFFECTS [1] OF TAX EXPENDITURES, BY ADJUSTED GROSS INCOME CLASS, 1983—Continued

Adjusted gross income class (thousands)	Total returns filed		Tax expenditures					
			Employer Pension Plans		Health Insurance		Life Insurance	
	Number	Cumulative percent distribution	Amount (millions)	Cumulative percent distribution [2]	Amount (millions)	Cumulative percent distribution [2]	Amount (millions)	Cumulative percent distribution [2]
$20 to $30	17,254	37.2	−6.3	82.6	−5.5	74.0	−.5	80.6
$30 to $50	13,538	18.8	−9.6	60.0	−6.4	45.7	−.7	56.6
$50 to $100	3,384	4.3	−5.0	25.9	−2.1	12.9	−.3	21.9
$100 to $200	549	.7	−1.7	8.1	−.4	2.2	−.1	6.7
$200 and over	116	.1	−.6	.2	−.1	.4	([3])	1.9
Total	93,600	NA	−28.1	NA	−19.6	NA	−2.0	NA

[1] Revenue loss data derived from NIPA information presented in table 2. Distribution among adjusted gross income classes was calculated according to information in Revising the Individual Income tax.

[2] Percentages cannot be obtained from data due to rounding.

[3] Less than $0.05 billion.

Note.—NA = not applicable.

Source: Congressional Budget Office, Revising the Individual Income Tax (July 1983), tables 7 and 9, pp. 58, 60, and 61.

If the generous provisions associated with the fringe benefits are allowed to continue for the growing array of new benefits, the payroll and income tax bases will be reduced to the point where they can no longer be considered even approximations of ability to pay. What then is the outlook for the future of fringe benefits?

III. The outlook for employee benefits

The social security trustees project that the ratio of benefits to total compensation will increase by 0.3 percent annually. A decade ago such a forecast might have been viewed as somewhat high, since the work force appeared fairly well saturated with the traditional statutory benefits. Recent developments, however, reveal considerable interest on the part of both the employee and the employer in expanding the role of nontaxable compensation and a willingness on the part of Congress to provide new mechanisms with which to accomplish this goal. In order to assess the reasonableness of the social security projection, let us first examine the outlook for the traditional statutory benefits and then turn to the likely development of the more recently enacted forms of benefit plans.

Traditional statutory benefits

Coverage for any of the three major benefits—pensions, health, and life insurance—is unlikely to expand much further. The percentage of the civilian work force covered by these plans has remained almost constant since 1970 and a recent study by the Bureau of Labor Statistics showed that coverage in medium and large firms, the main providers of employee benefits, was nearly universal—97 percent of employees in these firms had health insurance, 96 percent had life insurance and 84 percent had retirement pensions. Moreover, the shifting industrial structure in the United States tends to make further major increase in coverage unlikely. Industries with traditionally higher benefit coverage, such as manufacturing, are expected to employ a declining share of workers, while employment in industies with low benefit coverage, such as retail trade and services, is projected to increase.

Some increase in the ratio of benefits to compensation should be expected, however, from benefit improvements and rising costs of the traditional fringe benefit plans. In the case of private pension plans, pressure is almost certain to develop for some form of post-retirement cost-of-living adjustments and in the health insurance area, medical costs are likely to continue increasing at a more rapid pace than the general price level. Thus, there will probably be a moderate expansion in the proportion of compensation contributed to traditional employee benefits.

New types of benefits

The major source of growth in nontaxable employer-provided benefits, however, will probably come from the proliferation of new types of plans. In the last ten years a host of tax-favored employee benefit provisions have been introduced and other benefits have been moved from the realm of administrative ruling to statutory standing.

The extension of statutory benefits began in 1974 with incentives for employers to establish employee stock ownership plans (ESOPs) for their employees (see Table 5). The next step was a substantial increase in the list of services that could be provided tax free by employers for their employees. These include prepaid legal services, employer-provided transportation by commuter van between home and work, educational assistance for tuition, books and supplies, and dependent care assistance for children and incapacitated dependent adults. The only requirement imposed on these benefits is that they be provided on a nondiscriminatory basis that does not favor officers, shareholders, or highly compensated employees.

TABLE 5.—EXPANSION OF STATUTORY EMPLOYEE BENEFITS, 1974 TO THE PRESENT

Year	Statutory benefit	Legislation	Provision[1]
1974–81	ESOP's	Employee Retirement Income Security Act of 1974.	Singled out employee stock ownership plan (ESOP's) as only benefit plans that could be used as a vehicle for corporate borrowing, by exempting ESOP's from certain fiduciary standards regarding diversification and parties-in-interest transactions.
	ESOP's	Tax Reduction Act of 1975.	Permitted corporations to take an additional 1 percent investment tax credit if the funds were invested in ESOP's.
	ESOP's	Economic Recovery Tax Act of 1981.	Revised the investment tax credit associated with ESOPs so that the additional allowable credit is based on the lesser of either the total value of employer securities transferred to the ESOP or a prescribed percentage of annual compensation of all employees covered by the plan.[2] The credit expires on Jan. 1, 1988.
1976	Legal services	Tax Reform Act of 1976	Allowed employees to exclude from gross income the value of employer contributions to qualified prepaid legal services plans, as well as the value of any legal services provided. Applicable to self-employed individuals. Expires Jan. 1, 1985.
1978	Van pooling	Revenue Act of 1978	Allowed employees to exclude from gross income the value of employer provided transportation to and from work by commuter van. Not applicable to self-employed individuals. Expires Jan. 1, 1986.
1978	Educational assistance.	Revenue Act of 1978	Allowed employees to exclude from gross income the value of employer provided educational assistance. Applicable to self-employed individuals. Expired Jan. 1, 1984.
1978	Cafeteria plans	Revenue Act of 1978	Eliminated the doctrine of "constructive receipt". Allowed employees to exclude from taxable income the value of benefits chosen under a qualified cafeteria plan if the benefit would have been nontaxable in the absence of the plan.
1978–80	401(k) plans	Revenue Act of 1978	Allowed employees to reduce their salary by up to 15 percent of compensation and to invest money tax tree in a deferred compensation account.
	401(k) plans	Miscellaneous Revenue Act of 1980.	Allowed 401(k) plans to be included in cafeteria plans.
1981	Dependent care assistance.	Economy Recovery Tax Act of 1981.	Allowed employees to exclude from gross income the value of employer provided dependent care assistance.
1984	General guidelines.	Deficit Reduction Act of 1984.	Allowed employees to exclude from gross income the value of 1) "no-additional-cost" benefits; 2) qualified employee discounts; 3) "de minimis" benefits; 4) working condition benefits; 5) on-premise athletic facilities, and 6) tuition reductions.
			Limited inclusion in cafeteria plans to statutory nontaxable benefits and cash.
			Allowed the lending institution to exclude from gross income 50 percent of interest on loans made to ESOP's

[1] In addition to these specific provisions, most statutory fringes must comply with nondiscrimination requirements in order to qualify as tax exclusions. In general, statutory fringe benefit plans must be nondiscriminatory with respect to eligibility, contributions and benefits. If a plan is determined to discriminate in favor of officers, shareholders or highly compensated employees, the otherwise applicable income exclusion is denied. The Deficit Reduction Act of 1984, however, exempted "de minimus" and "working condition" fringe benefits from nondiscrimination requirements.

[2] The prescribed percentage is 0.5 for 1983 and 0.75 for 1985, 1986, and 1987.

Sources: Joint Committee on Taxation, "Pamphlet Prepared by Joint Committee on Taxation on Administration Proposal to Tax Employer Provided Medical Insurance and Explanations of Tax Treatment of Benefits" (June 1983); Peter Henle and Jane G. Groweell, "Employee Stock Ownership Plans: Current Status and Proposed Legislation," Congressional research Service Multilith No. 75–159E (July 1975); and "Analysis of the Employee Benefit Provisions of the deficit Reduction Act of 1984 (Public Law 98–369) and Text of Pertinent Sections of the Law," Special Supplement to BNA Pension Reporter (Sept. 3, 1984).

A third innovation was the encouragement of so-called "cafeteria" plans that allow employees to select from a menu of benefits and salary packages with a variety of health, vacation, insurance, retirement and other benefits. This development became possible with the enactment of Section 125, which removed restrictions imposed by ERISA on cafeteria plans that offered the option of cash or a taxable benefit. Essentially, ERISA said that the right to elect cash or a taxable benefit constituted "constructive receipt" even if the employee did not actually make such an election. The 1978 legislation provided that the application of tax was to be based on the actual election of taxable benefits, and thereby paved the way for the establishment of cafeteria plans covering a wide range of taxable and nontaxable benefits.

The same legislation also authorized so-called section 401(k) plans that allow employees to reduce their salary by up to 15 percent of compensation and invest the money tax free in a special account. As in the case of pension plans, interest is allowed to accumulate tax free until the funds are distributed. Legislation passed in 1980 permits 401(k) plans to be part of a cafeteria plan.

Finally, the most recent relevant legislation, the Deficit Reduction Act of 1984 (DEFRA), awarded statutory standing to a list of benefits that had generally been viewed as tax-exempt by the public. Although early attempts were made to tighten up the rules for the taxation of those nonstatutory benefits, the final legislation essentially codified existing employer practices. In the process of expanding statutory nontaxable benefits, however, the act did impose restrictions on the types of benefits that can be included in cafeteria plans. Beginning in 1985, choices under a qualified cafeteria plan will be restricted to statutory nontaxable benefits and cash.

As a result of DEFRA, fringe benefits offered by the employer will be excluded from taxable income if they qualified under any one of the following categories: 1) Services provided at no additional cost to the employer, such as airline seats to airline personnel and their families; 2) Qualified employee discounts up to 20 percent for goods sold in the normal course of the employer's business; 3) Benefits used in the employee's work, such as a company car, if at least 85 percent of the benefit would be classified as work related; 4) Other benefits that fall under a de minimis exclusion such as picnics for company employees, small Christmas gifts, and subsidized cafeterias. In addition, special exemptions will be allowed for qualified tuition reductions, employee parking, and athletic facilities.

In short, new fringe benefits are constantly being introduced and will probably constitute an ever increasing portion of total compensation.

IV. Proposal for reform

Given that the growth in fringe benefits is likely to continue, the question then becomes what should be done. Although Congress and the Treasury have expressed concern aout the trend towards workers taking more compensation in tax-free benefits, Congress has so far limited reforms to relatively minor actions, such as curtailing benefit practices that are clearly aimed at tax avoidance. I think that the time has come for more comprehensive approach to tax reform, and that the reform should be logical and consistent with the principles of the nation's tax policy rather than an ad hoc response to looming federal deficits.

Any economist will tell you that, for purposes of tax equity, the theroretically pure solution would be to establish a comprehensive definition of compensation for both income and payroll tax purposes. Under such a definition, the value of the employer's contributions for health and life insurance and the increase in the value of accrued pension benefits would be included in the employee's income. Employer contributions for dependent care, van pooling and educational assistance would also be included in income, and salary reduction schemes, such as 401(k) plans, would be repealed.

While such a reform would not be extraordinarily difficult to implement for either the payroll or income tax, such a dramatic change might have undesirable economic consequences. The basic statutory benefits have been awarded preferential status under the tax code precisely because it was deemed desirable to encourage certain types of activities. Almost everyone agrees that the favorable tax treatment has contributed significantly to the expansion of pension, health, and life insurance plans. On the other hand, the existence of fringe benefits cannot be attributed to tax policy alone. Pension plans, for example, have existed long before the income tax, reflecting employers' needs for an impersonal and egalitarian mechanism to retire super annuated workers. However, because the precise role played by tax preferences in the growth of the basic statutory benefits is not known, it would probably be unwise to dramatically alter the current treatment and include the full value of these benefits in the tax base for income tax purposes. On the other hand, it does seem both desirable and feasible to include all fringe benefits in the definition of taxable wages under the payroll tax.

A precedent already exists in the taxation of 401(k) plans for treating fringe benefits differently under the income and payroll taxes. The codification of the Rowan decision provides that an exclusion of income for income withholding shall not affect the treatment of income for payroll tax purposes. As a result of the 1983 Social Security Amendments, employee contributions to 401(k) plans are included in the payroll tax bases even though they are deductible under the income tax.

The 401(k) experience also seems to indicate that the application of the payroll tax alone to an employee benefit does not have a seriously adverse impact on its adoption and growth. Recent surveys indicate a dramatic expansion of 401(k) plans. Not only are they continuing to expand among large companies, but are increasingly being adopted by middle-sized firms, which is surprising since innovations in benefits generally take some time to trickle down from the largest employers. Nevertheless, a recent survey by Meidinger, Inc. indicates that half of the medium-sized firms who responded to the survey (256 firms in 38 states) said they were taking positive action toward adopting 401(k) plans or already has such a plan in place.

In short, it is theoretically desirable, administratively practical, and economically feasible to include all fringe benefits in the payroll tax base. This change will increase short-term revenues by roughly $30 billion per year, allow Congress to reduce the scheduled 1988 and 1990 payroll tax increase by half and reduce the long-run costs of the system by 0.5 percent of taxable payrolls. Moreover, the applicability of the employer's share of the payroll tax to employee benefits removes the incentive for the employer as well as the employee to prefer noncash payments.

While identical treatment of fringe benefits under the income tax may not be desirable, some reforms are obviously necessary in order to avoid becoming a society where workers receive half their compensation in wages and half in fringes. The most obvious compromise is to place an overall limit on the amount of fringe benefits—including pensions—that workers can receive tax free or tax deferred under the income tax. Setting such a limit must necessarily involve some degree of arbitrariness, but would restrain the erosion of the tax base without subjecting most of the work force to an immediate increase in their tax liability. If a single number had to be selected it should probably be slightly above the current benefits to compensation ratio of 12.5 percent that prevails in the manufacturing sector. Perhaps, 15 percent of total compensation might be reasonable. A preferable approach, however, would be to allow a generous amount of nontaxable benefits as a percentage of compensation at lower income levels and reduce the percentage as income increases. For example, nontaxable benefits could account for 25 percent of the first $40,000 of compensation, 15 percent of the next $40,000 and 5 percent of any compensation over $80,000.

Thus, my recommendation is twofold: to tax fringe benefits in full under the payroll tax and to establish an aggregate progressive limit on tax free or tax deferred fringes under the income tax.

Mr. HEFTEL. Next, Joseph Minarik, Urban Institute.

STATEMENT OF JOSEPH J. MINARIK, SENIOR RESEARCH ASSOCIATE, THE URBAN INSTITUTE

Mr. MINARIK. Thank you, Mr. Chairman. I would like to emphasize as Alicia did, that I am speaking for myself and not for the Urban Institute. I would like to congratulate the chairmen of the two subcommittees for holding these hearings. I think it is very important at this time, now that the Deficit Reduction Act has codified the treatment of tax-exempt fringe benefits, that we take a look at what we have in the law.

Particularly, at this time when the deficit is such a pressing concern, it is clearly very important that we look at any exclusions from the tax base of this size to consider where we stand with respect to the budget and what can be done to reduce the deficit.

I would like to just go into a few points, to emphasize some things that Alicia said and disagree with her very slightly on her conclusions. First of all, I think it is most important that we understand that from the various sources of information that we can see, coverage under fringe benefits does vary considerably from one industry to another, among different classes of workers and by income levels.

So for example, we have professional workers in the economy, half of whom are covered by both health insurance and pension benefits. We have agricultural workers who are covered only in proportion of about one in ten. We have service workers and construction workers who are covered only about one in four. So clearly we have tax-exempt fringe benefits going to particular classes of workers, and not to others.

We have industry breakdowns where, in manufacturing as opposed to construction, for example, coverage of fringe benefits is much more intensive. Now this raises two very important issues. The most important one, I think, is the fairness issue. We are talking here not so much, I think, about an issue of what one income group gets as opposed to another income group. I think the key point is that at any given income level, there are workers who receive vastly different degrees of fringe benefit coverage, where in some cases we have coverage of a quarter of payroll in tax-exempt fringe benefits, and there are other workers, particularly those in small firms, who receive no coverage whatsoever.

So as far as the equity concern is involved, it would be important to make the tax base more comprehensive, so that most workers who do not receive fringe benefits are not at a disadvantage compared to others with the same cash compensation who receive more in fringe benefits. Then I think there is an important issue of economic efficiency. We have exclusions from the tax base. Those exclusions reduce the amount of income subject to tax. And given that the Federal Government has to raise a certain amount of revenue in order to meet its needs, that means tax rates have to be higher.

That is a double example for economic efficiency. One is that they reduce incentives. Second, those taxpayers who do not receive any tax-exempt fringes because the tax rates are driven up, have to pay at those higher statutory rates. And so in both cases we have concerns both on efficiency and also fairness with respect to the exclusions we have for fringe benefits. Another thing is that fringe benefit products become cut-priced goods in that workers will bargain for tax-exempt fringe benefits to the extent that they can get them, even though they may be valued at less than an equivalent amount of cash.

So, for example, an employee in a 30-percent tax rate bracket would prefer to receive 70 cents in subjective value worth of fringe benefits to a dollar's worth of taxable compensation. I would conclude from these problems that the best way to deal with the equity issues and with the efficiency issues is to subject fringe benefits to taxation, both under the income tax and under the payroll tax.

The reason for that is that in order to provide equity for equally situated taxpayers given that the income tax is the heavier tax, income taxation would be the appropriate remedy for the inequities we have in the system right now. The caps that have been discussed do limit the overuse or abuse of the fringe benefit opportunities do not deal with the efficiency consideration where, underneath the cap, employees can still prefer to receive tax-exempt benefits.

An excise tax has also been discussed as a remedy. This has a benefit of dealing with the distortions, of providing some additional cost to tax-exempt fringe benefits and therefore preventing their expansion as completely tax free goods. However, it does not address the equity issue to the extent that the excise tax is only a partial substitute for the full taxation that would occur if these fringe benefits were taxed under both the income and payroll taxes. So I think it would be preferable to put fringe benefits in both the income and the payroll tax bases.

The difficulty under the current income tax is that we have tax rates that are high and we have exclusions that are perhaps inadequate, considering that some workers receive substantial amounts of fringe benefits simply in the form of health insurance at low income levels. So I think it would be important under these circumstances to consider the possibility that adjustment of the program parameters of the income tax, including some of the tax rates, and possibly the exemptions and zero brackets be considered, as well.

Finally, I think it is important that we consider the effects that taxation would have on benefit strategies. It is not, I think, a fair statement that we have a choice of tax-exemption of fringe benefits or no fringe benefits at all. In particular, health insurance is most effectively and most efficiently provided thorough the private market, and, in particular, health insurance is least expensive on a group basis.

That suggests that employers will be the most logical sources of health insurance coverage for employees. And so the issue here is not so much choosing between fringe benefits and Government programs such as national health insurance. It is, rather, providing an equitable and efficient means of taxation for compensation of employees. Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF JOSEPH J. MINARIK, SENIOR RESEARCH ASSOCIATE, THE URBAN INSTITUTE

The Chairman of the Subcommittee on Social Security and the Subcommittee on Select Revenue Measures are to be congratulated for holding these hearings on employer-provided fringe benefits. The fringe benefit issue has gained increasing importance as fringes have grown, narrowing the tax base. With the Deficit Reduction Act providing the tax treatment of fringe benefits, it is a good time to take stock of the non-cash compensation paid in the economy, and its effect on employees and the tax system.

In my statement today, I would like to discuss the proper tax treatment of employer-provided fringe benefits, and the characteristics of fringe benefits that are important to the appropriate tax treatment. This approach will show why we want a neutral and fair tax treatment of all forms of employee compensation, and how we should achieve it.

TAX PRINCIPLES FOR EMPLOYEE COMPENSATION

The federal income tax starts from a principle of taxing income from whatever source derived. The Social Security payroll tax, for programmatic reasons, starts from a narrower base of employee cash compensation and self-employment income, but it allows no deduction whatever from that base. So both of these taxes, in principle, seek a tax base that is as comprehensive as possible.

There are two reasons for taxing broad measures of income, with minimal exclusions permitted:

First, it is fairer. A taxpayer who may exclude some of his income excluded from tax while others may not enjoys an unfair advantage. So, for example, no one would argue on first principles that workers in the utilities and communications and mining industries should pay less tax than those in services and agriculture; or that professional and managerial workers should pay less than sales personnel and laborers; or that workers in large firms should pay less than those in small firms, all else equal. But that is the effect of the current law. The utilities and communications and mining industries make benefit payments equal to more than 40 percent of their wage and salary outlays, while the service and agriculture industries pay 25 percent or less (U.S. Chamber of Commerce, Employee Benefits 1982). More than half of professional and managerial workers receive both health insurance and pensions coverage, but only about 25 percent of sales personnel and laborers do (Timothy M. Smeeding, "The Size Distribution of Wage and Nonwage Compensation: Employer Cost vs. Employee Values"). And workers in large- and medium-sized firms are significantly more likely to receive employee benefits than those in smaller firms (Statement of Dallas L. Salisbury before the Senate Finance Committee, August 7 and 9, 1984). So some groups are systematically disadvantaged relatives to others by the current exclusions for fringe benefits.

Second, a broad tax base is more efficient. A tax base that is broader can yield a given revenue at lower rates; that reduces disincentives and distortions. Further, if exceptions from a tax are granted, taxpayers will seek to receive their compensation in the exempt form, reducing revenue and total income in the economy. Thus, exclusions for employer-provided fringes are expected to cost the Treasury over $150 billion by 1988; that revenue loss forces tax rates up.

So in principle, employer-provided fringe benefits should not be excluded from our tax bases.

Like all rules, the broad and uniform tax base has exceptions. Like all exceptions, these are often claimed in vain to justify unjustifiable decisions. The conditions under which these principles should be violated are strictly limited.

Some exclusions from our tax bases subsidize worthwhile activities that would not be undertaken on their own. Some might argue that employer-paid health insurance fits this description—that without a tax subsidy, workers would go without health insurance, impoverishing themselves or leaving society holding the bag when they became ill. Alternatively, it might be argued that the federal government would be left to fill the gap with an expensive national health insurance program.

These arguments don't stand up. There is no evidence that employees would choose to drop their employer-provided health insurance if the tax exclusion were cut back or eliminated. Over recent years, as medical care and health insurance have become more expensive and tax treatment has been constant, workers have purchased more health insurance, not less. With the currrent cost of routine medical care and the possibility of catastrophic expenses, health insurance is a necessity, and everyone knows it. Employer-provided insurance would continue to be popular without the tax exclusion because group insurance is the most economical form. With a continued healthy private insurance market, there would be no more demand for national health insurance than there is now. Other insurance subsidies, for dental and legal insurance, for example, have a much weaker rationale on their own. These benefits might be dropped without the tax subsidy, but no important national purpose would be lost.

Pension subsidies, the other major tax-favored employer benefit, might be better defended on these grounds. Young and middle-aged workers might well forgo saving for retirement, which seems far away, while they would protect themselves against medical bills, which are an immediate threat. Further, the availability of tax-deferred IRAs for those not covered by employer plans makes the pension exclusion less of an equity issue. (Of course, the availability of those same IRAs as a double-dip for those who are covered by employer plans mitigates this argument somewhat.) One might argue with the generous upper limits for contributions to pension plans, however, even after the cutback in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). Employers can deposit in pension reserves each year free of tax amounts roughly equal to the median family income, or can allow accrual of annual pension rights equal to about three times the median income. Prudent preparation for retirement is one thing, but we might wonder whether a public subsidy is fitting for feathering a nest quite so luxuriously.

A second justification for tax exclusions is relief for hardship. This can hardly be argued for employer-financed fringe benefits, because the working population receiving the fringe benefits are comparatively well-off. Further, the benefit of the tax exclusion is greatest for those with the highest incomes, because the tax savings are greatest for those in the highest marginal tax brackets. So hardship or fairness are no justification for the exclusion of employer-financed benefits.

A third possible justification would be administrative difficulty with measuring and taxing the benefits. This justification, too, does not hold for the major fringe benefits. Health and life insurance premiums are determinable for individual workers, and can be reported to workers on their W-2 forms just like cash wages. Fully vested contributions to defined contribution plans could be reported the same way; partially vested contributions or accruals under defined benefit plans require actuarial assumptions, but those assumptions are far from complex for plan administrations.

So the only real justification for continuing the fringe benefit exclusions at their current generosity is inertia.

CHARACTERISTICS OF TAX-EXEMPT FRINGE BENEFITS

The use and distribution of the major employer-paid fringe benefits are partly determined by the nature of the benefits themselves, and partly by the tax exemption.

Who gets what

Medical insurance.—Employer-paid medical insurance is widely received among full-time employees in large- and medium-sized firms, but less so in smaller firms. Medical insurance costs roughly approximate an equal per capita expense; while more comprehensive coverage is more expensive, the difference between the most and least generous plans is comparatively limited. More or less of that cost may be paid by the employer and therefore be tax-exempt, according to the bargain struck between employer and employee. In any given firm, the difference in the deal for higher- as opposed to lower-wage workers is limited by anti-discrimination requirements. Thus, tax-free medical insurance premiums are distributed relatively equally across the population; the tax benefit of the exemption is a function of the marginal tax rate, and therefore greater for the more highly compensated employees.

Life insurance.—Employer-paid life insurance is the most widely received of the major fringe benefits, and is nearly universal among full-time employees of large- and medium-sized firms. The amount of employer-paid life insurance is generally some multiple of annual income. Premiums increase with age, and older workers tend to earn more. Thus, the amount of employer-paid premiums tends to increase in proportion to income. The tax exemption is limited to $50,000 worth of life insurance, however, and so the tax benefit is capped at some maximum amount.

Pensions.—Like life insurance premiums, pension contributions tend to a fraction of income, and the maximum tax exemption is capped. Pension contributions are much larger than life insurance premiums, however, and the maximum tax-exempt contributions are quite large. Further, young and new employees, who tend to be less highly compensated, can be excluded from pension plans for a time and subjected to gradual vesting. Thus, pension contributions are the most exclusive of the major employer-financed benefits. Anecdotal evidence suggests that a major benefit to highly compensated employees has been arranging the maximum tax-exempt pension contribution that the anti-discrimination laws allow. Thus, these contributions tend to be relatively heavily concentrated among highly paid workers, and the tax benefits even more heavily concentrated because of the graduated tax rate schedule.

Bargaining

Employers are indifferent between spending a marginal dollar on cash compensation or on fringe benefits, because both are tax deductible as legitimate business expenses. Employees, on the other hand and all else equal, would prefer fringe benefits, because they are tax deductible. Thus, tax-exempt employer contributions are a kind of mad money, and are treated more lightly than taxable dollars. An employee in the 30-percent bracket is indifferent between one dollar in wages and fringe benefits that he would value at 70 cents.

The limit in employee bargaining for fringe benefits is determined by the declining marginal value of life and health insurance and pension contributions. Contributing to this declining value is the increasing number of two-worker couples, and thus, duplicative employer-paid health insurance. One advantage to workers of limiting the maximum employer contribution to a basic health insurance plan for single people is that working spouses can choose this most limited coverage, which they do not need anyway if the other spouses if fully covered, and take home more cash.

CONSEQUENCES OF TAXING FRINGE BENEFITS

Payroll tax

Subjecting these major fringe benefits to payroll taxation would augment the total taxable wage base by about 10 percent of its current amount. Relatively small amounts of life insurance premiums would be added, increasing with income across the income scale; larger but more nearly equal amounts of health insurance premiums would be added for most employees, with some, probably those with lower wages, receiving none; and pension contributions of amounts increasing sharply with income would be added as well. If the taxation of pension contributions were restricted to the highest contributions of top-heavy plans, there would be virtually no tax consequences.

Some of the augmentation of the tax base would be lost, because the benefits are received by workers already exceeding the maximum taxable compensation. This suggests that augmentation of the tax base should be accompanied by an increase of the taxable maximum, to maintain full coverage of a high percentage of the work force. Likewise, the payroll tax rate might be reduced, to lessen the additional tax on low- and middle-wage workers who receive life and health insurance benefits.

The bottom line of payroll taxation of fringes, however, would be that the tax would come closer to a levy on total compensation. This would be both more equitable and more efficient.

Income tax

Taxation of fringe benefits would augment the income tax base by income group in the same fashion as it would the payroll tax base; the only difference would be that the taxable maximum would not apply. This means that the largest pension contributions would be taxable, and in all probability would not be made. Employers would tend to limit contributions to permissible tax-exempt amounts, and employees would take any excess as cash compensation, and in all likelihood save it themselves.

Because the income tax rates are so much higher than the payroll tax rate, income tax increase for fringe benefit recipients would be that much larger. So opposition from recipients and their representatives would be that much more vigorus. The appearance of such a change taken in isolation would be Uncle Sam singling out wage and salary workers and drafting their money for the war on the budget deficit.

This suggests that some compensating changes in the income tax might be made. To protect low-income workers from substantial tax increases, the personal exemption and especially the zero-bracket amount, which are overdue for increases anyway, might be raised. Alternatively, the tax rates at the low- and middle-income level could be reduced. Because these changes are expensive, particularly the personal exemption increase, progress may be more likely in the context of a broader tax restructuring bill than as an isolated reform of the handling of fringe benefits.

The bottom line should not be lost, however. It is that subjecting employer-paid fringe benefits to the income tax would be more efficient, by treating different types of income and expenditure alike, and fairer, by taxing workers with equal total compensation the same way. It would not be an unfair burden on recipients, considering other taxpayers who do not receive fringe beneifts. The distributional impact is not an argument against taxing benefits, because standard deductions, exemptions and tax rates can be adjusted to attain any distributional outcome desired.

Caps on tax-exempt benefits

Current law imposes caps on tax-exempt life insurance and pension contributions. Anti-discrimination regulations might be seen as implicit caps on tax-exempt contributions under different programs.

Individual benefit caps limit the use of particular tax-exempt benefits. To some degree, this can be like capping one rabbit hole, merely increasing the flow through other holes from a well-developed warren. There can be particularly important outlets, however, as in the cap on the contributions to pension plans. The Administration-proposed health insurance contribution cap may be similarly important, in that the tax exemption has encouraged expensive first-dollar coverage, which can make employees totally insensitive to the price of medical care.

Nonetheless, partial caps do not prevent extremes of overall use of tax-exempt fringe benefits, nor do they necessarily impose their limits in any relationship to the total compensation or income of the worker. Further, they do not make all workers face the market price, rather than a tax-exempt "discounted" price, of fringe benefits. Thus, item-by-item caps do not serve the overall purposes of tax policy.

An alternative would be an overall cap on tax-exempt fringe benefits from whatever source. That kind of a restriction would be more keyed to the total amount of tax-exempt compensation, but not to total compensation (unless the cap were expressed as a percentage of total compensation). Further, a cap would not eliminate the inequity of the relative treatment of taxpayers at any given income level with more or less fringe benefits. Some of the effects of a total cap would depend on the treatment of existing item caps. If item caps were lefted, more taxpayers and more fringe benefits would go back to the zone where fringes are cut-price goods, thus increasing distortions. If the item caps were not lifted, there might be a cry for applying unused fringe allowances to shelter cash compensation, narrowing the tax base. So an overall cap would have an upside and a downside.

Excise tax on fringe benefits

Another option is an excise tax on fringe benefits, or on contributions above some tax-free amount. Such an excise would prevent fringes from being quite so inexpensive at the margin, and thus could slow the fringe benefit explosion.

Again, there is a question of how an excise on excess contributions would be coordinated with existing item caps. If the caps were continued, contributions defined as acceptable by a cap could be taxed by the excise. If the caps were lifted, use of some fringes could expand beyond what is now considered an acceptable amount. Unlike a general cap, an excise tax would not be likely to induce a campaign for tax exemption of cash compensation for those with little or no fringe benefits.

Except for its limit on the amount of taxable compensation, the Social Security payroll tax probably fits the description of an acceptable excise tax for otherwise exempt fringe benefit contributions. Consideration might be given to using the payroll tax in that role.

Nonetheless, the excise tax would likely be proportional, rather than progressive, and so when compared to the income tax it would be relatively more rigorous for low-wage than for high-wage workers. To eliminate the distortion of worker choices, and to link the tax on fringe benefits to total compensation, income taxation would be superior to an excise tax.

LIKELY TAXPAYER ADJUSTMENTS

If fringe benefits were subject to taxation, workers would want to adjust their mix of compensation. This is a cost of transition, but it is not a significant disadvantage; it says that workers' choices are distorted by the current tax treatment, a problem that we should want to remedy.

One issue would be the terms of existing multi-year collective bargaining agreements. Presumably, there should be a prospective effective date in the law to avoid implicit changes in existing contracts. If grandfathering of existing contracts were chosen with an immediate effective date, however, there would be a coordination problem between the grandfathered tax exclusions and any compensating tax rate cuts or tax allowance increases. Grandfathered workers could get the best of both worlds—not having to pay tax on their fringe benefits for a time while enjoying a general tax cut intended to compensate them for the added burden.

A second problem would be the health insurance coverage of two-earner couples. Where one spouse has duplicative coverage under current law, the only disadvantage is that that spouse would prefer to receive the cash that pays the premium rather than the insurance. If that premium were taxable, however, there would be an actual tax burden for insurance coverage that is neither wanted nor needed. Presumably, such a worker should be permitted to refuse the insurance coverage, and possibly even allowed to take the premium money in cash. This requires institutional changes to give taxpayers more choice. It also raises problems of improvident taxpayers circumventing the system to take cash compensation instead of health insurance, and then dumping any catastrophic medical bills on society. Obviously, some new institutional arrangements will be needed.

Mr. HEFTEL. Our next panelist is Kenneth Simonson, President's Commission on Industrial Competitiveness.

STATEMENT OF KENNETH D. SIMONSON, PRESIDENT'S COMMISSION ON INDUSTRIAL COMPETITIVENESS, AND SPECIAL ASSISTANT TO THE CHAIRMAN, MILLIPORE CORP.

Mr. SIMONSON. Thank you. I am speaking for myself only today and no other organization. I would like to have my testimony submitted for the record and just to summarize a few principal points.

Mr. HEFTEL. So ordered.

Mr. SIMONSON. I will focus today on employer-paid health and life insurance, mainly because I think that Members of Congress have done a good job of dealing with the so-called nonstatutory benefits this year, thanks to the leadership of Chairman Stark and Mr. Conable, and because they have looked repeatedly at the pension area.

I don't think we have had the last word on either of those problems, by any means. But at least they have gotten close attention. Therefore, I will focus on health insurance, the largest and fastest growing area of fringe benefits and life insurance. In my opinion, both belong in the tax base for income and Social Security tax purposes.

Adding them to those bases would eliminate the strong bias that now exists toward giving benefits and against cash compensation. The static revenue gain from such a change would be large, but that gain may evaporate as employers and workers adjust. The distributional effects also need to be taken into account, because workers at various income levels would be affected differently. Finally, I will comment on the role of fringes in two broad income tax restructuring bills that this committee may take up.

It is especially heartening to see the Social Security subcommittee look at fringes. All of the tax restructuring bills that I have examined, and the current Treasury study, from what I hear of it, ignore Social Security, as if neither the tax nor the benefits side had any connection to income tax restructuring. Some economists are guilty of encouraging such bifurcated thinking, by saying in effect that "Social security revenues and outgo are projected to be in balance (knock on wood), so there is no reason to examine that part of the tax system." That advice sits well with many politicians of all stripes, whose attitude seems to be, "If it ain't goin' broke today, don't mention it, let alone fix it."

Yet Social Security is inevitably affected by decisions about the income tax treatment of fringe benefits. The more broadly the income tax is restructured, the more Social Security is likely to be affected. They are intimately linked and I think it is essential you look at the entire Tax Code when considering major tax restructuring plans.

You have heard a lot of figures this morning and yesterday on the magnitude of fringe benefits and their likely growth. As an economist, I know how hazardous it is to project the growth of any number. And I will not try to do that. I would like to point out, though, that according to the national income accounts that were released last month for 1983, group health insurance had grown 65 percent since 1980, while wages and salaries had grown only 22 percent, or one-third as fast, over that span.

Outlays for group health insurance totaled $82 billion last year. Outlays for group life insurance another $7.6 billion. Together these benefits accounted for 5.4 percent of wages and salaries that year, up from 4.1 percent as recently as 1980, and more than double the 2.6 percent rate of 1971.

So while I can't say how fast these benefits will continue to grow, I think they have already reached a very substantial level and are clearly growing much faster than wages and salaries. Therefore, I think they merit your attention now. In particular they deserve attention because they are unevenly distributed. A survey by the U.S. Chamber of Commerce that you, I believe, are well aware of, shows that premiums accounted for 6.7 percent of payroll in 1982 and by 1983 that figure had probably climbed to over 7 percent.

If you take out the firms that did not pay any benefits and also adjust for the growth of premiums from 1982 to 1983, it appears that the size of benefit per covered employee in 1983 was about $1,500. That is a substantial amount of income to let out of either the income or the payroll tax bases. I believe the principal justification in most people's minds for exempting health insurance from taxation is that it is a good thing to have broader health insurance coverage.

That ought to lead to a healthier population. I have no quarrel with the idea that we would like to have a population as healthy as possible. However, I think that the current blanket exemption for health insurance is a very inefficient way of achieving that goal. It not only provides for many kinds of coverage that probably do little to boost the overall health of the covered population. It leaves many workers with inadequate coverage. Finally, by encouraging those workers who are covered to make greater use of health services, they tend to bid away those services from other persons who may be needier, but do not have the same resources.

As a result the population as a whole may not be any better off than they would be if we drastically revised the current tax treatment of health insurance.

I think the case for exempting life insurance from taxation is even weaker. Very few people would be left destitute if we removed the exemption from employer-provided life insurance.

And finally, I think including both of these in the tax base would not mean the end of employer-provided benefits in this way. Certainly, there are economies of scale to having employer-provided group coverage, rather than for each individual to go out and purchase coverage. And I think that employers would still be providing group coverage.

However, individuals would be buying that coverage out of after-tax dollars, and, I think, would choose more carefully what level of coverage was appropriate for them. So I believe that putting health insurance in particular into the tax base would lead to a much more rational choice of the amount of health care we want. While that is not strictly the subject of today's hearing, I think is a major concern of the committee which has so much of the health system under its jurisdiction.

The incentive now from a worker's standpoint from leaving health and life insurance and for that matter, other benefits, out of the tax base, is substantial. The average marginal individual income tax rate is somewhat over 20 percent today. In addition the combined employer and employee rate on Social Security tax is 13.7 percent this year and will be going up to 14.1 percent in a few months.

Finally, State and local income taxes generally follow the definition of compensation used for the Federal income tax. Therefore, even average income workers are facing a 35 to 40 percent tax rate on wage income, if you include both employer and employee shares of Social Security tax. And they have that large incentive to seek exclusion of fringe benefits rather than taking cash compensation even if the fringe benefit would not be worth nearly as much to them as cash, in a nontax world, or in a world in which the tax treatment was equal for both of those.

You have heard figures on the amount of revenue loss from excluding fringe benefits from income and Social Security tax.

The estimates for the Social Security base tend to vary widely. I have one estimate in my testimony, and derived another estimate from some Joint Committee on Taxation staff figures. I notice in the pamphlet for this hearing that they have come up with a third estimate. But I think all of those should be taken with a large dose of salt because once you put the benefits under an income and payroll tax system employers and workers would adapt.

These estimates all assume that there would be no change in the level of benefits offered. Nevertheless, there should be significant tax consequences for both the income and payroll tax basis. I agree with Dr. Munnell that we would have been able to avoid some Social Security tax increases in recent years, or upcoming ones, if we had put these benefits into the payroll tax base. To put the benefits into the income tax base would involve a number of distributional consequences.

As Joe Minarik and witnesses on the first panel pointed out, coverage tends to be very uneven. Small businesses, for instance, provide less coverage. And in general, workers at the lower end of the income scale get less benefit from fringes than do upper income workers.

On the other hand, health insurance benefits, which as I mentioned are the largest category of employer-provided fringes now, tend to be a flat dollar amount per person, more or less an excise tax on each worker. Therefore, low income workers get, in proportion to their wages, a larger benefit from health insurance coverage than upper income workers. Moving health insurance into the income tax base would seem, then, to fall hardest on those workers if employers adjusted by cutting back their benefits. Therefore, I think that if you are considering taxation of health and life insurance, and I realize you are probably very reluctant to do so because of their broad popularity, you should do that in the context of a general tax restructuring plan.

I have looked at two bills that do restructure the tax system. In part, by including health and life insurance in the tax base. Those are the Fair Tax Act of 1983 introduced by Representative Gephardt and Senator Bradley and a bill proposed by Senator Quayle called the SELF Tax Plan Act of 1985. He has not introduced that yet, but has described it in the Congressional Record. And for that bill he has made it explicit that his definition of fringe benefits would apply for Social Security tax purposes as well as income tax purposes.

In contrast, the Bradley-Gephardt bill does not make that clear, from my reading of it. However, I think that the static tax impacts would be similar; namely, that you would get a tax increase of as much as $13 billion in Social Security revenues. If these bills are revenue neutral overall, that is, for income and payroll tax purposes, as they purport to be, that employees that they have a large income tax reduction and are making that up by adding substantially to payroll tax receipts.

Now, the payroll tax falls much more heavily on lower to middle income workers than does the income tax. And I think you need to look carefully at those distributional effects of both taxes, if you consider a broad-scale reform of the tax system.

Finally, let me comment briefly on two halfway measures to including life and health insurance fully in the tax base. I think that a cap on life and health insurance, or health insurance alone, would be better than what we have now. However, it would not avoid all of the administrative problems laid on employers by attributing each dollar of health insurance to an employee. And it would also create a perverse incentive to some extent to raise the amount of health insurance that employees under the cap were taking, so that the net effect on tax receipts might be quite small.

A second alternative is to put an excise tax on employers. If you do this, you would avoid all the problems of trying to divide up benefits for each employee. You wouldn't have to worry about taxing employees on an income tax for which they may not have had withholding take place. On the other hand, you would have to be careful I think, if you really wanted to avoid an incentive for taking extra fringe benefits, you would need quite a substantial excise tax rate.

As I mentioned before, 35 to 40 percent would approximate the average benefit that employees get now. And that rate would have undesirable distributional consequences because low-income workers now have a combined tax rate that is well below 35 to 40 percent, and workers at the top a combined rate that is substantially above that. So the excise tax would have the effect of encouraging employers to hire more high-income workers, rather than low.

Thank you.

Chairman PICKLE. Thank you very much.

[The prepared statement follows:]

STATEMENT OF KENNETH D. SIMONSON, SPECIAL ASSISTANT TO THE CHAIRMAN, MILLIPORE CORP.

Thank you for inviting me to testify today. Let me make clear at the outset that I will be presenting my own views as an economist and not necessarily those of my employer.

I wish to commend both of these subcommittees for exporing this topic today, just before the full committee takes testimony on tax reform generally. Taxation of fringe benefits poses some of the trickiest problems to resolve in redesigning the tax system. Yet because total restructuring involves so many questions, the more complex issues like how to tax fringes tend to be ignored or given a once-over-lightly.

To summarize briefly: I will focus today on employer-paid health and life insurance. In my view, both of these items belong in the tax base for income and social security tax purpose. Adding them to those bases would eliminate the bias toward benefits and against cash compensation. The static revenue gain from such a change would be large, but that gain may evaporate as employers and workers adjust. The distributional effects also need to be taken into account, because workers at various income levels would be effectived differently. Finally, I will comment on the role of fringes in two broad income tax restructuring bills.

It is especially heartening to see the social security subcommittee look at fringes. All of the tax restructuring bills that I have examined, and the current Treasury study, from what I hear of it, ignore social security, as if neither the tax nor the benefits side had any connection to income tax restructuring. Some of economists are guilty of encouraging such bifurcated thinking, by saying in effect that "Social security revenues and outgo are projected to be in balance (knock on wood), so there is no reason to examine that part of the tax system." That advice sits well with many politicians of all stripes, whose attitude seems to be, "If it ain't goin' broke today, don't mention it, let alone fix it."

Yet social security is inevitably affected by decisions about the income tax treatment of fringe benefits. The more broadly the income tax is restructure, the more social security is likely is to be affected.

This year Congress tackled a number of long-standing and vexations fringe benefit problems, thanks in part to the leadership of Chairman Stark and Rep. Conable. Taxation of retirement benefits, including pensions, has also been reviewed and changed significantly in recent years. But two major categories of fringe benefits, group health and life insurance, have been largely ignored.

MAGNITUDE OF BENEFITS

Group health insurance is the largest and fastest-growing category of compensation, totaling $82 billion in 1983, according to the National Income and Product Accounts published by the Commerce Department. That figure is 65% higher than in 1980, while wages and salaries grew 22% over the same span. Outlays for group life insurance totaled another $7.6 billion in 1983. Together these benefits accounted for 5.4% of wages and salaries that year, up from 4.1% as recently as 1980, and more than double the 2.6% rate of 1971.

Even the 5.4% number is understated, because it compares premiums to wages paid all employers, even ones that did not pay premiums. A survey by the U.S. Chamber of Commerce of 1507 businesses, most of them large, shows that among firms that paid premiums, the premiums accounted for 6.7% of payroll in 1982 (Employee Benefits, 1982, Table 12, p. 17). The 1983 figure probably exceeds 7%, given the rapid growth of payments.

The same survey shows that combined payments for life and health insurance premiums by all 1507 firms averaged $1274 per employee in 1982 (Table 8, p. 13) Averaging this total just over firms that paid premiums and adjusting it for the growth of premiums suggests that the cost in 1983 per covered employee was roughly $1500. About 90% of that total was for health insurance.

WHY EXEMPT FRINGES

What justification is there for continuing to exempt fringes from taxation? It might be argued that fringes do not fit under the definition of gross income, or of compensation for FICA (social security) tax purposes. But that implies that workers have not received anything of substantial value, an assumption that would be disputed by any worker at the same cash income level who does not receive a fringe benefit. It also suggests that all health and life insurance purchased by taxpayers (employees or not) on their own behalf ought to be deductible. Such a deduction would no doubt please insurance sellers, but it would hardly help the fisc. One is forced to conclude that fringes are income, and to look elsewhere for a reason to exempt them.

Two plausible reasons for exempting health insurance are to promote greater health in the populaiton and to protect people from catastrophic medical costs. However, the current exclusion does not serve either of these rationales well. It is an efficient means of spreading a safety net under people who might be bankrupted by medical bills. The exclusion applies to many types of noncatastrophic medical coverage, and it does not assure that covered employees will be given coverage protecting them from economic hardship.

Unfortunately, the exclusion does not necessarily lead to better overall health of the population, either. It undoubtedly enables covered employees to purchase more health care than they would pay for out of after-tax dollars, and presumably they are healthier as a result. But their purchases drive up the cost of care, reducing the amount purchased by the rest of the population, who may well need health care more than covered workers and their families. (Where medical supplies or services are especially scarce, the quantity available to noncovered persons might be affected more than the cost.) Moreover, removing the exclusion would not automatically lead to wholesale abandonment of health insurance. Employees would still find employer-provided group health insurance less expensive in many cases than individual coverage.

The case for excluding life insurance from income is even shakier. The value of the premiums is appropriately part of gross income. The exclusion induces workers to buy more life insurance than they would buy out of after-tax dollars. Such a decision is not likely to benefit the rest of society enough to warrant the loss of revenue unless the choice leaves less of a burden on society than would after-tax insurance purchase.

Most of the premiums cover employees who would not place an added burden on society even without the subsidy. Some of these employees have sufficient life insurance, social security, pension, and other wealth to provide for their survivors; others have no dependents; still others would purchase additional protection out of after-tax dollars. Relatively few employees would gamble and lose in a way that would cost society if the exclusion were abolished.

WHY TAX FRINGES

A worker who receives health and life insurance in addition to wages is clearly better off than one who receives the same wages and no benefits. The first worker has higher total compensation and disposable income. Therefore, employer-paid insurance properly belongs in the income and FICA (social security) tax bases.

Including premiums in income will reduce the tax bias against taxpayers who do not receive benefits. It will encourage covered workers to choose between insurance and other forms of compensation without basing their decision on tax considerations. That in turn, should lead to workers selecting a more appropriate level of insurance.

In the case of health insurance, such a choice is one vital step in allowing market forces to set how much health care the nation can afford. Workers will select health services more prudently if they directly pay additional tax when the amount of health insurance they buy rises. Moreover, placing health insurance under FICA implies that additional money flows to the medicare trust fund when workers buy health insurance. This can be viewed as a way of compensating medicare recipients for the costs imposed on them by employees who use more health services.

There is also an income redistribution argument for taxing fringes. In general, workers who choose greater benefits must give up cash compensation, because employers (at least private-sector ones) will only send a given amount on labor services for a given level of output, whether the payments take the form of salary, benefits, or employers' payroll taxes. The workers who have the least incentive to seek additional fringe benefits are the ones in the lowest marginal tax bracket, and thus the lowest income. They are also the ones who can least afford to give up cash income in order to have their employers pay them in the form of benefits which are not tradable for items they may need more urgently.

HOW SHOULD FRINGES BE TAXED

In principle, the full employer's full cost of providing the insurance should be attributed to each employee and reflected on the annual W-2 wage statement. If this attribution is made only at year end, many employees would owe substantial tax on which no withholding had occurred. In addition, a retroactive statement of health insurance costs would do little to make employees aware of how much they had chosen. Thus, including the costs in each pay period would be better for workers. However, employers may find it burdensome to calculate insurance-related costs on a weekly or monthly basis, particularly for employers who self-insure or handle substantial administrative functions for insurers, such as claims processing.

Congress should take a comprehensive approach to allocable costs, so that there is no bias for or against having employers subsidize health services by self-insuring or providing services directly, for instance through in-house clinics. But employers and employees should be given flexibility in finding ways of developing health-care options. For instance, some employers who process claims might decide to charge employees on a per-claim basis, whereas others may decide they can minimize total costs by dividing claims among all covered employers without keeping track of individual claims. There is no clear reason for Congress to prescribe or proscribe either method.

If Congress decides that the administrative costs of allocating all employer-paid health expenses to individual employees are excessive, there are two partial alternatives. One is the Administration's health insurance "cap" proposal, to allow costs up to $70 per month for individuals and $175 for families to remain tax-exempt. This cap would let employers avoid recordkeeping and tax collection for millions of workers who choose lower-cost plans, and give workers and insurers a clear incentive to choose plans that are under the cap. On the other hand, some employers would still incur large administrative costs, and employees who now choose less than the maximum tax-free amount might decide to increase their health coverage up to the cap.

The second alternative is to put an excise tax on employers for the amount of health-care costs rather than allocating the cost to employees. This spares employers from having to figure out how much to assign to each worker and avoids imposing tax on workers for noncash income. (Congress could extend the tax base to other benefits whose cost is identifiable at the employer level but hard to allocate individually, such as subsidized cafeterias.) If the excise tax rate is set equal to the sum of the combined employer-employee FICA rate plus the marginal income tax rate for the average employee, the revenue impact should be equal under this alternative. Such a tax rate would be roughly 35-40% (14% for FICA and somewhat over 20% for individual income tax). However, workers would not have as direct an incentive to economize on insurance as they would if the cost and tax appeared on their pay statements and tax returns. Furthermore, use of a single tax rate would mean that low-income workers were taxed more heavily on benefits than on cash compensation, and high income workers the reverse, a result that does not fit most notions of equity.

CONSEQUENCES OF TAXING HEALTH AND LIFE INSURANCE

The reason for taxing these benefits is to remove the bias that now exists for both employers and workers to choose benefits over cash compensation and to improve the price mechanism in the delivery of health care by making workers more aware of the cost of those services. An added rationale that you may hear is that this would be a potent revenue source.

At least in theory, a lot of revenue could be raised by including group insurance premiums in taxable compensation. The "tax expenditure" for lost income tax receipts from excluding health insurance from individual returns totaled $15.3 billion in fiscal 1983, with the amount estimated to grow to $20.0 billion by fiscal 1985, according to Special Analysis G of the Fiscal 1985 Budget. The comparable figures for life insurance are $2 billion in fiscal 1983, rising to $2.4 billion in fiscal 1985.

In addition, I estimate that, on a static basis, over $10 billion of FICA receipts would have been collected in 1983 by including health and life insurance in the social security tax base for employers and employees. (One of the many shortcomings of the "tax expenditure" concept mentioned above is that it ignores all taxes except corporate and individual income.) This estimate assumes that $80 billion of the $89.6 billion spent by employers on premiums would have been allocated to employees whose income was below the FICA wage ceiling and thus would have been taxed at the 13.4% employer-employee rate.

Before Congress decides to mine this lode, however, several cautionary notes should be sounded. First, the potential revenue gain may not be all that it seems. Employers and employees alike adjust their behavior in the face of rising taxes. If employers must start paying FICA on health and life insurance, they will, over time, cut back on those or other items—or do without some workers altogether. Therefore, if employers must pay FICA on the health insurance they offer, they will respond by reducing their total compensation costs by a like amount. Thus taxable compensation will not rise by the full amount that intially is added to the tax base. Even if employers do not bring total compensation back down to its previous level, there will be some reduction in federal receipts because taxable employers will have incurred an additional deductible expense.

The response to making fringes taxable will differ according to the employee's wage rate. For highly paid employees, those above the maximum taxable level for FICA ($37,800 in 1984, projected to be $39,300 in 1985), the employer will face no additional cost from making fringes taxable. Conversely, the worker will be liable for additional income tax, but not FICA.

At the other extreme, employers cannot react to additional costs by cutting wages for workers earning the minimum wage. They can respond only by absorbing the cost, cutting benefits, or eliminating the job. Thus workers at the low end of the wage ladder are likely to bear the brunt of employer adjustments to this added tax, by losing benefits or perhaps even their job. Even if their employer absorbs its share of FICA on the benefits, the workers' already small after-tax wage income will be reduced by the employee share of FICA and possibly income tax.

A more severe consequence for low-income workers arises from the fact that health benefits are basically a flat amount per employee and are not proportional to income. Thus, putting social security tax on these benefits implies that workers at all income levels would pay the same dollars amount of tax. This amount would have been about $200 per worker in 1983 (assuming $1500 per worker in benefits and a 13.4% tax rate that year.) Such an amount is obviously much easier for a high-paid employee to absorb than for a minimum-wage worker. Conversely, employers will be more willing to absorb the $100 employers' share in the case of a $35,000-per-year worker than a $10,000–year worker. Both of these effects suggest that low-wage workers have the most to gain if employers substitute straight pay for insurance.

The vast majority of workers fall between these two ends of the wage spectrum. How will they be affected? They may face the largest additional tax burden, because they would owe FICA (at a employer-employee rate of 13.4% in 1983 and 13.7% in 1984) as well as income tax, whereas employees who are above the wage ceiling would own only income tax. Thus, a single worker receiving $24,500 of pay and taxable benefits in 1984 would face a combined federal income and payroll tax rate on additional benefits of 43.7%. In contrast, a single worker receiving between $37,800 (the 1984 FICA wage ceiling) and $56,300 would pay no more than 42%.

Of course, this pattern of rates already applies to wages. Little wonder then that workers increasingly show a preference for nontaxable fringes. This preference should diminish if the fringes become taxable at the same rate as cash.

To sum up: An exclusion for health and life insurance does not serve a valid social purpose and does distort workers' preferences between straight pay and benefits. The overuse of health insurance in particular has harmful side effects in terms of driving up the cost of health care for noncovered individuals (or for the taxpayers who fund medicaid and medicare). Full taxation of these benefits would encourage employers and employees alike to lessen their preference for benefits over wages. Such a switch back to cash would help lowest-wage workers the most, although they would pay a disproportionate share of the tax on benefits.

TAX RESTRUCTURING BILLS AND FRINGES

Most likely Congress would want to combine any such change with broader tax restructuring. The best-known bill that contains a combination of taxing fringes but providing other forms of relief is the "Fair Tax Act of 1983" (H.R. 3271/S. 1421), introduced by Rep. Richard A. Gephardt (D-Mo.) and Sen. Bill Bradley (D-N.J.). That plan would include employer-provided health insurance, life insurance and other statutory fringe benefits in individuals' gross income. The sponsors have never made clear whether those items would also be included in the wage base for social security (FICA) tax purposes, although I have been told that the staff of the Joint Committee on Taxation (JCT) did make such an assumption in doing revenue estimates for the bill. You would do everyone concerned about tax reform a great service if you could clarify and make public this information.

In contrast, Sen. Dan Quayle (R-Ind.) has shed some light on the static revenue consequences (that is, assuming no employer or employee response) from including fringes in the income and FICA tax bases. In a Senate floor statement (*Congressional Record*, June 12, 1984, pp. 6990–94), he provided data from the JCT staff on the effects by income class of his proposed "SELF-Tax Plan Act of 1985." That plan explicitly includes currently nontaxable fringes in the tax base for individual income tax and for both employer and employee shares of the FICA tax.

Additional FICA receipts from the inclusion of health and life insurance and other fringes would amount to $13.2 billion under the SELF-tax at 1984 rates and 1981 income levels, according to JCT estimates. The receipts under the Bradley-Gephardt plan and other bills that add these items to the FICA base would be about the same, irrespective of how their income tax rates differ. This is a large sum, equal to well over 5% of the FICA receipts actually collected that year and possibly enough to have averted the near-panic over social security's solvency that occurred in 1982. (It is about 50% higher than my rough estimate, but both should be taken with a large dose of salt, because the assumption of no response by employers and employees to reduce this tax load is clearly unwarranted.)

Even more startling is the effect on the distribution of tax liabilities from including these receipts. Here the particular results apply only to the Quayle plan, but the direction of change is just as applicable to any bill that attempts to keep overall receipts by income class roughly the same as under present law (such as Bradley-Gephardt). Under the Quayle proposal, only 20.6 million taxpayers would have *income* tax increases, vs. 60.5 million who would receive income tax cuts. But the number with combined income and FICA tax increases (counting employer's share of FICA as well as employee's share) jumps to 55.6 million, while the number receiving tax cuts drops to 54.6 million.

Nearly all of the taxpayers who are added to the tax-increase side of the ledger have low expanded incomes. (Expanded income is adjusted gross income plus certain tax preferences; it is the income measure generally used by the JCT staff to present income distribution data.) To be specific, 36.4 million out of the 55.6 million tax-increase cases have less than $10,000 of expanded income. Evidently, 29 million of these taxpayers owe no income tax but do receive employer-paid fringes that would be subject to social security tax under the plan. Many of these taxpayers are among the working poor.

These effects are summarized in the following table.

EFFECTS OF "SELF-TAX ACT OF 1985" ON INCOME AND FICA RECEIPTS—COMPARED TO MARCH 1984 LAW, AT 1981 INCOME LEVELS

Expanded income range (thousands)	Returns with tax decrease (millions)		Returns with tax increase (millions)		Net change (billions)	
	Income tax only	Income + FICA tax	Income tax only	Income + FICA tax	Income tax only	Income + FICA tax
0 to $10	15.0	14.4	5.9	36.4	−$1.8	$1.5
$10 to $20	21.3	9.5	3.1	5.0	−8.7	−6.0
$20 to $30	13.1	11.6	4.1	5.6	−6.3	−3.1
$30 to $40	5.9	5.1	3.4	4.2	−1.9	.2
$40 to $50	2.2	2.0	1.9	2.1	−.1	.8
$50 to $75	1.3	1.2	1.5	1.6	1.2	1.8
$75 to $100	.4	.3	.4	.4	.5	.6
$100 to $200	.4	.4	.3	.3	−.5	−.4
$200+	.1	.1	.1	.1	−1.1	−1.0
Total	60.5	54.6	20.6	55.6	−18.8	−5.6

Source: Compiled by the author from JCT staff simulations.

In the absence of data on the Bradley-Gephardt bill, it is impossible to verify the sponsors' claim that that bill would leave each income class approximately as well off as at present.

(For a fuller discussion of several tax restructuring bills and the impact that changes in fringe benefits taxation and other features have on the distribution of tax burdens, I hve attached my article, "The Not-So-Level Playing Field of Revenue Neutrality," Tax Notes, August 13, 1984.)

In short, restructuring bills that attmept to maintain the current-law distribution of tax burdens have very different effects, depending on whether they take social security receipts into consideration. I urge you to look at the whole tax code when you are considering proposals to restructure either fringe benefits or income taxation generally.

SPECIAL REPORT

TAX ANALYSTS

THE NOT-SO-LEVEL PLAYING FIELD OF REVENUE NEUTRALITY

by Kenneth D. Simonson

Kenneth D. Simonson, a Washington tax economist, is special assistant to the chairman of Millipore Corporation. This article represents his views only.

In this article, Mr. Simonson notes that the Bradley-Gephardt, Kemp-Kasten, Quayle, and DeConcini tax restructuring proposals all profess to be revenue neutral in that they would raise the same amount of revenue in their first year as would be raised under present law. The author finds that except for Sen. Quayle, the sponsors are either unable or unwilling to state the actual revenue effects of their bills. He notes that the bills differ as to which revenues would be held constant and that the base-broadening encompassed within the bills is likely to produce a substantial increase in payroll tax liabilities for employers and employees.

The author suggests that the notion of revenue neutrality is not a very useful guide to policy and that revenue neutrality is possible only under very artificial assumptions. He suggests that using revenue neutrality as a benchmark may lead to selection of a tax restructuring plan that is undesirable on both economic efficiency and deficit control grounds.

Sponsors of recent tax restructuring plans deserve faint applause for professing to make their bills "revenue-neutral." The applause is for attempting to separate the issue of how much revenue to raise from how to raise it. The faintness is for the lack of candor or clarity with which they state what they mean by revenue neutrality.

Revenue neutrality sounds straightforward: merely change the law so as to collect the same amount of tax as under current law. Why make such a change? To make the tax law fairer, simpler, or more efficient. A revenue-neutral proposal lets people compare "apples and apples": without arguing about how much revenue should be raised overall, they can decide whether present law or the alternative satisfies these other aims better.

At least five tax restructuring plans currently receiving attention purport to be revenue-neutral. These include the "Fair Tax Act of 1983" (S. 1421/H.R. 3271), introduced by Sen. Bill Bradley (D-N.J.) and Rep. Richard Gephardt (D-Mo.); the "Fair and Simple Tax Act of 1984" (H.R. 5533/S. 2600), introduced by Rep. Jack Kemp (R-N.Y.) and Sen. Bob Kasten (R-Wis.); the "SELF-Tax Plan Act of 1983" (S. 1040), introduced by Sen. Dan Quayle (R-Ind.); a revised "SELF-tax" described by Quayle in a Senate speech (*Congressional Record*, June 12, 1984, pp. 6990-94); and the "Flat Tax Act of 1983" (S. 557), introduced by Sen. Dennis DeConcini (D-Ariz.). (Details of the plans were compared in David R. Burton's "Major Tax Reform Proposals at a Glance," *Tax Notes*, June 4, 1984, pp. 1095-1100.)

The sponsors, except DeConcini, claim not only that their bills are revenue-neutral, but that they would keep the revenue collected from each income group unchanged. How well do these claims stand up? Unfortunately, no one, except possibly the sponsors, can say, for two reasons. First, only one sponsor has offered proof in the form of independently prepared data. Second, the authors have not made clear which revenues would be kept even.

Where's the Proof?

Only Sen. Quayle has gone public with revenue estimates from the staff of the Joint Committee on Taxation (JCT). (See Barbara N. McLennan and Kenneth D. Simonson, "Income Distribution Effects of Moving to a Broad-Based, Low-Rate Individual Income Tax," *Tax Notes*, February 6, 1984, pp. 509-18, for estimates on S. 1040, the "SELF-Tax Plan Act of 1983." See Sen. Quayle's floor statement in the *Congressional Record* for estimates on his revised propoal.)

Revenue neutrality is a static concept which assumes no change in taxpayer behavior or economic conditions as a result of the tax change, an obvious impossibility.

Sen. Bradley and Rep. Gephardt have said the JCT estimates for their bill show that it would be neutral, but they have refused to make the figures public. Rep. Kemp and Sen. Kasten say that their bill would be revenue-neutral for most income classes and lose revenue for upper-income groups, but they also have refused to provide specifics. Sen. DeConcini evidently does not have JCT data for his bill. Still, he asserts that his bill would be revenue-neutral, based on a calculation presented by Robert Hall and Alvin Rabushka in their book *Low Tax, Simple Tax, Flat Tax*. That book estimates that the bill would have been revenue-neutral in 1981, with rapidly rising revenues thereafter, although their estimation method differs from the JCT's method.

The static approach may work well for many tax provisions that make only minor changes in law, but it breaks down for large-scale restructuring bills.

Compared to What?

The federal government derives most of its revenue from three main sources—individual income tax, corporate income tax, and social security payroll tax, which includes taxes on employers, employees, and self-employed. The restructuring plans all would explicitly change the definition of taxable income and the rates for the personal income tax. They all would change the corporate tax but do not all spell out how. None specifies changes in the payroll tax, but the Bradley-Gephardt and Quayle plans would include in wage income employer-paid fringe benefits such as health and life insurance. Including fringe benefits in the definition of wages could affect payroll tax receipts as well.

It is not always clear whether the sponsors intend that the broader definition of wage income would apply for social security payroll tax purposes as well. This point is important, because at current payroll tax rates (a combined employer-employee rate of 13.7 percent in 1984, 14.1 percent in 1985), adding roughly $100 billion of fringe benefits to the tax base would produce a large amount of added payroll tax receipts.

Only the 1984 Quayle proposal relies explicitly on added social security payroll tax receipts to approach revenue neutrality. That proposal is estimated to reduce individual income tax receipts by $18.8 billion but add $13.2 billion to social security's coffers (counting employer and employee shares). The net impact is a revenue loss of $5.6 billion, or 1.2 percent of combined income and payroll tax receipts for 1981.

Quayle's 1983 bill, S. 1040, apparently also would add to social security receipts, but he did not state that explicitly. That bill would have cut 1981 income tax revenues by $7.4 billion, or 3.4 percent. Although Quayle considered this loss small enough to call the bill income tax-neutral, it seems more accurate to call it income tax-losing and income plus payroll tax-neutral, like his 1984 plan.

Bradley and Gephardt have not made clear whether their broader definition of wage income would apply for social security purposes. These effects would apparently be similar to those in the 1984 Quayle plan: that is, a revenue gain of $13 billion. Assuming their bill is revenue-neutral with respect to income plus payroll taxes implies that the bill would cut income tax receipts by the same amount.

In contrast, Kemp and Kasten do not redefine taxable wage income. Thus their bill would apparently leave social security receipts unchanged. Whether they leave other receipts constant seems less likely. Their explanatory materials state that their plan would raise approximately as much as present law, but also that taxpayers below $20,000 would get a small reduction on average, as would taxpayers over $100,000. Corporate rates would be cut as much as under Bradley-Gephardt (more for small amounts of income), but Kemp-Kasten contains fewer offsetting corporate revenue raisers. Thus, Kemp-Kasten appears to lose revenue in both its individual and corporate provisions, with no pickup from payroll receipts. In other words, it is not actually revenue-neutral.

DeConcini would totally replace corporate and individual income taxes with a business tax and a compensation tax. The latter would tax wages as currently defined and thus would bring in less revenue than the current personal income tax. The business tax would apply to income from capital, plus fringe benefits paid by business, corporate and noncorporate. This tax would raise more revenue than the current corporate tax. Together the taxes are intended initially to equal the receipts from today's income taxes. DeConcini evidently does not intend to broaden the social security tax base, although making fringe benefits subject to business tax might also open them up to payroll taxation. It is assumed in the table below that his bill would match the sum of individual and corporate receipts in the first year and would not change social security receipts.

In summary, it is unclear what revenues are being kept neutral under most of these bills, because the authors have not detailed their proposals sufficiently or have not provided reliable revenue estimates. Nevertheless, if one accepts the sometimes shaky assumptions above, the following pattern emerges.

Table 1

CHANGE IN RECEIPTS FROM PRESENT-LAW LEVELS

Plan	Individual	Payroll	Corporate	Total
Quayle ('84 plan)	down	up	neutral	neutral
Quayle (S. 1040)	down	up	neutral	neutral
Bradley-Gephardt	down	up	neutral	neutral
Kemp-Kasten	down	neutral	down	down
DeConcini	down	neutral	up	neutral

Neutral for Whom?

Although the plans (other than DeConcini's) claim to be roughly revenue-neutral by income class as well as overall, this type of revenue neutrality is much harder to achieve. Quayle's floor statement shows why.

He reproduces JCT figures showing that in 1981, over 50 million taxpayers had less than $10,000 of expanded income (adjusted gross income plus tax preferences less investment interest expense to the extent of investment income).

Under Quayle's proposals total income and payroll tax receipts of that group would stay nearly constant, rising by 2.9 percent from $53.1 billion to $54.7 billion. But this is achieved by raising payroll taxes on 30 million individuals. Counting employer and employee shares of the social security tax along with income tax changes, over 36 million taxpayers would face increases; 14 million, decreases. Looking just at income taxes, nearly 16 million returns would have tax cuts vs. only 6 million increases. The net change in income tax receipts would be a decline of 40 percent, from $4.4 billion to $2.6 billion. These effects are shown in Table 2.

Table 2

TAX INCREASES AND DECREASES UNDER 1984 QUAYLE PLAN FOR UNDER-$10,000 EXPANDED INCOME CLASS

	Returns with Increases		Returns with Decreases		All Returns	
	No.	Amt.	No.	Amt.	No.	Amt.
	(mil. $)	(bil. $)	(mil. $)	(bil. $)	(mil. $)	(bil. $)
Income tax only	5.9	$2.1	15.9	-3.9	21.8	-1.8
Income + payroll tax	36.4	4.8	14.4	-3.3	50.8	1.5

Bradley-Gephardt would presumably have similar effects, if it uses higher social security receipts to offset lower income tax receipts. In both cases, only taxpayers whose wage income is below the social security ceiling ($37,800 of wages in 1984, projected to be $39,300 in 1985) face this combination of lower income taxes and higher payroll taxes.

Quayle's figures illustrate another point that applies to all restructuring bills. Even when there is no change in aggregate liability for a group, many individuals in the group face large increases or decreases. For instance, Quayle's 1984 plan would raise the combined income and payroll tax liability of the $30-40,000 expanded income class by only $0.2 billion, or 0.2 percent. But the average tax decrease for the 5.1 million returns with decreases in that class would be $772, while the average increase for the 4.2 million returns with increases would be $966. Since these are averages, obviously some individuals would have even larger shifts in liability.

Similarly, revenue neutrality for corporate taxation applies only on an aggregate basis. Any firm or industry is likely to face large changes in its tax bill, depending on the degree to which various corporate tax rates, credits, deductions, and other terms are altered. But to the extent the tax burden on one industry changes, there will be impacts on the customers, employees, and stockholders of firms in that (and other) industries. These impacts make the ultimate personal or corporate effects of a restructuring plan still less predictable.

For instance, Bradley-Gephardt makes investment in equipment less attractive by eliminating investment credits and reducing the present value of depreciation deductions. Industries that use large amounts of machinery, equipment, or structures may suffer relative to ones that now have high effective tax rates and small amounts of depreciation or tax credits. Those industries would gain from the bill's cut in the corporate tax rate from 46 to 30 percent.

Does Low-Income Mean Poor?

It is hard to maintain revenue neutrality for low-income taxpayers because there are at least two types of them. Low-wage taxpayers may have little or no income tax liability, because either they have enough dependents to eliminate tax, or they qualify for a second-earner deduction and earned-income or child-care credit. A couple with two dependents can earn as much as $17,812 in 1984 (if they have equal salaries and $4,800 in dependent-care costs) before paying income taxes.

Taxpayers below this income level do not necessarily benefit from increases in the zero bracket amount (ZBA) or personal exemption, two features of most restructuring plans. But they do pay more in social security, and possibly income, tax if their wage base is redefined to include fringe benefits. They are also vulnerable to "simplification" or "base-broadening" that cuts down on their credits and second-earner deduction.

Other *seemingly* low-income taxpayers may be dependents of wealthier families who must currently file because their parents have put some income from capital in children's names to escape taxation at the parents' higher rates. Arguably, they do not need tax relief on their own account, but bills that raise the personal exemption do grant them relief. Similarly, some taxpayers with low expanded income (and many with low adjusted gross income) may have large gross income from certain sources offset by losses. Whether these losses disappear under a restructuring bill depends on the specific base-broadening contained in the bill.

Table 3 shows how a moderate-income family and a wealthy dependent would fare under present law and each proposal. These taxpayers are not meant to be representative. Indeed, one point of the examples is that each income class covers a wide range of tax situations. The examples do illustrate the direction in which liabilities would change for a number of taxpayers.

Taxpayer A is a family of four. Their income of $16,000 (less than 150 percent of the projected poverty line for a family of four in 1985) comes from wages. Both parents work full-time at $4 an hour (15 percent above the minimum wage) and receive a modest amount of employer-paid health insurance. They spend $3,600 on child care. Under present law their income tax after child-care credits is only $15. Under the alternatives, their income tax would be anywhere from $308 to $1459. The Bradley-Gephardt and Quayle plans would apparently also subject their health insurance to payroll tax, adding $141 to the combined employer-employee tax in 1985. Moreover, the marginal rate is at least as high under all alternatives as under present law, meaning that small amounts of additional income would be taxed at least as heavily under all these proposals. Two-earner families with less income or higher child-care expenses also would pay more tax under all alternatives.

Even when there is no change in aggregate liability for a group, many individuals in the group face large increases or decreases.

Taxpayer B is a minor whose wealthy parents claim him as a dependent but have put assets in his name so that $2,000 of income is taxed at his marginal rate rather than theirs. His liability amounts to $110 under present law, $56 under Bradley-Gephardt and $0 under Kemp-Kasten. (Individuals would not pay tax directly on capital income under DeConcini, which is accordingly omitted from this example.) For higher amounts of income, "poor little rich kids" like Taxpayer B save even more under Bradley-Gephardt, and at some levels under Quayle, although not under Kemp-Kasten.

In short, many taxpayers who are classified as having low income on their tax returns are not poor but still would benefit under some restructuring bills. Conversely, some working poor and near-poor would face increases in aggregate income tax (or income plus payroll tax) burdens. The fact that a bill cuts some rates and broadens

Table 3

TREATMENT OF TWO TAXPAYERS UNDER PRESENT LAW AND ALTERNATIVES

	Present Law	Bradley-Gephardt	Kemp-Kasten	Quayle S. 1040	Quayle '84 Plan	DeConcini
A. 2-earner family with 2 children. Each spouse receives $8,000 in wages, $500 in employer-paid health insurance. Child-care costs are $3,600.						
Wages	$16,000	$16,000	$16,000	$16,000	$16,000	$16,000
Taxable health insurance		1,000		1,000	1,000	
Exclusion*	-800		-3,200			
Adjusted gross income	15,200	17,000	12,800	17,000	17,000	16,000
Personal exemptions	-4,000	-5,200	-8,000	-4,000	-4,000	-1,620
Child-care deduction		3,600				
Zero-bracket amount	-3,400	-6,000	-3,500	-10,000	-10,000	-6,700
Taxable income less ZBA	7,800	2,200	1,300	3,000	3,000	7,680
Tax before credits	987	308	325	420	450	1,459
Child-care credit	-972					
Tax after credits	15	308	325	420	450	1,459
Marginal rate*	14%	14%	25%	14%	15%	19%
B. Child who is a dependent on parents' return but receives $2,000 in interest income in own name.						
Adjusted gross income	$ 2,000	$ 2,000	$ 2,000	$ 2,000	$ 2,000	
Personal exemption	-1,000	-1,600	-2,000	-1,000	-1,000	
Taxable income less ZBA	1,000	400	0	1,000	1,000	
Tax	110	56	0	140	150	
Marginal rate	11%	14%	0%	14%	15%	

*Under present law, second-earner exclusion cuts effective marginal rate on earned income to 13.3 percent. Under Kemp-Kasten, wage exclusion cuts effective marginal rate on earned income to 20 percent.

the base does not assure that it helps all those who are truly moderate-income or hikes burdens for the "pseudo-poor."

Is Revenue Neutrality Meaningful?

Even if all restructuring bills used well-defined measures of revenue neutrality and were accompanied by publicly available data, the information would be of limited use. The concept does help distinguish bills that are meant to keep revenués (however defined) at close to current levels from ones that make no such effort, such as simple 10 percent flat-tax plans. But revenue neutrality is a static concept which assumes no change in taxpayer behavior or economic conditions as a result of the tax change, an obvious impossibility. In fact, one of the purposes of these bills is to foster changes, such as greater work, saving, and investment (at least in taxable activities).

Revenue neutrality for corporate taxation applies only on an aggregate basis.

The JCT staff is aware of this, but argues that it must make static assumptions to provide a common basis for comparison and to avoid argument over the nature and size of the changes that would be induced by the tax revision. The static approach may work moderately well for many tax provisions that make only minor changes in law, but it breaks down for large-scale restructuring bills. There would be large differences in actual receipts between Bradley-Gephardt, with its multiple rates, double taxation of some income, and extended depreciable lives, and DeConcini, with its one rate, single taxation of all income, and expensing.

Moreover, even if bills happen to achieve revenue neutrality for one year, they will not do so for future years. This result is guaranteed not only by the differences in revenue "feedbacks" that will occur over time, but by differences in how fast people become taxable or move into higher brackets. The latter differences are caused both by changes in the bracket and exemption levels and by changes in indexing from present law. These considerations make revenue neutrality still less useful a goal, if one assumes that the restructuring is intended for the long haul and not a single year.

Still another problem with revenue neutrality is that it gives an incomplete picture of effects on the deficit. For instance, a bill that makes every dollar of unemployment benefits taxable may induce people to forego some benefits, reducing government outlays. Conversely, a proposal that raises the marginal cost of working by abolishing earned-income and child-care credits, eliminating the second-earner deduction, raising the bottom rate, and subjecting fringe benefits as well as cash wages to income and payroll taxation is likely to lead some people to draw more in federal benefits rather than to start or keep working. The first bill thus might be *revenue*-losing but *deficit*-neutral; the second, *revenue*-neutral but *deficit*-increasing. The first bill would be preferable on either economic efficiency or deficit control grounds, yet focusing on revenue neutrality would lead to a preference for the second bill.

Conclusion

Revenue neutrality sounds like an objective, unambiguous, and desirable criterion for measuring tax restructuring proposals. On closer inspection, however, it is none of the above, and for numerous reasons is hard to apply to the plans currently being advocated.

The sponsors of current proposals have mostly failed or refused to say what revenues they would hold constant and have not presented evidence backing up their claims. Bradley and Gephardt refuse to release data. Quayle's data show that his 1984 plan is neutral for payroll and individual income taxes, but he fails to specify the nature of his corporate tax proposals, some of which bear on individual receipts also. Kemp and Kasten hint that their bill is actually a revenue loser but still call it revenue-neutral. The evidence on DeConcini suggests his bill could be either neutral or a large revenue gainer.

More generally, bills that keep revenues constant for lower-income groups may do so by penalizing those who are poor and benefitting the well-to-do who appear to have low income for tax purposes. Even calculating that a bill is revenue-neutral requires making patently absurd assumptions about taxpayer behavior. Finally, choosing a revenue-neutral bill over one that loses revenue may lead to perverse results for the deficit and the economy, even on a static basis.

Perhaps that applause for revenue neutrality should be still fainter.

Chairman PICKLE. Mr. Woodbury, with the Upjohn Institute.

STATEMENT OF STEPHEN A. WOODBURY, SENIOR RESEARCH ECONOMIST, W.E. UPJOHN INSTITUTE FOR EMPLOYMENT RESEARCH

Mr. WOODBURY. Thank you, Mr. Chairman. I am delighted to be here. I should mention immediately that I speak for myself and not necessarily for the Upjohn Institute or Michigan State University with which I am also affiliated.

What I would like to do is simply summarize my written testimony and emphasize a few points. My comments will focus on three issues. First, the growth of fringe benefits and reasons for that growth. Second, fringe benefit coverage and the implications of that pattern of coverage for income distribution. And third, equity of the tax system and revenue losses that result from fringe benefit exemption.

Everyone here is well aware of the dramatic growth of non-wage benefits during the post-World War II years. The fact of fringe benefit growth is simply not controversial. There is more controversy I believe over the causes of that growth. Several studies listed in my testimony have found convincing evidence that the favorable tax treatment of fringe benefits, that is their exemption from Federal income and payroll taxes has had a highly significant impact on employer provision of benefits.

Many readers of these studies and even one or two of the researchers themselves seem to have inferred from these studies that favorable tax treatment is the major—or even the only—cause of fringe benefit growth in recent years. I believe this is a serious error and for two reasons. First, the same studies also find that a variety of other factors have influenced fringe benefit growth; the growth of real incomes and the aging of the labor force deserve particular mention because they have increased right along with the marginal income tax rate. Further, they seem to have a positive effect on benefits of the same order of magnitude as do increases in the tax rate.

Second, I am less confident than some researchers that we have successfully separated the effects of rising real incomes from the effects of rising tax rates. This is a statistical issue I comment on more fully in my written testimony.

Why does all this matter? It matters I think because one of the most frequently used arguments against taxing fringe benefits is that by so doing employer-provided fringe benefits, health and retirement plans in particular, would be reduced or even would disappear. Statistical findings indicate this is simply not true. We would blunt one incentive and one incentive only for further growth of employer-provided benefits if we were to tax them.

The other forces behind fringe benefit growth would continue, however. Insurance and pension plans would still be a better buy when purchased through the employer. The work force would continue to age. Employers would still use deferred benefits as a means of reducing turnover. Real incomes would continue to grow. So we would not kill the goose that laid the golden egg and witness the demise of the voluntary fringe benefit system if we tax fringe benefits.

About the distribution of fringe benefits I want to make just one point. Taken as a whole voluntarily provided benefits do increase the inequality of the distribution of income. But there is one benefit, health insurance, that seems to be roughly proportionally distributed. Health insurance it seems neither greatly increases nor decreases the equality of the distribution of income.

Finally, a few words on the equity of the tax system and revenue losses that result from fringe exemptions. It is quite clear that the exemption of fringe benefits from taxation induces, introduces both vertical and horizontal inequities into the tax system. That is, those with greater ability to pay do not necessarily pay proportionally greater taxes. This follows from the fact that higher paid employees also receive a higher proportion of their total compensation as fringes on which they are not taxed. Also, two workers with the same total compensation may pay quite different tax bills if one receives only wage income whereas the other receives some fringe benefits. Finally, we are all acutely aware of the revenue losses resulting from the exemption of fringes.

The pure solution to these inequities and the revenue losses that result is the subjection of all employer contributions to Federal payroll and personal income taxes. Because of the opposition such proposals would likely meet, and have met, a variety of proposals to tax one benefit, health insurance, have been put forward.

Taxing health insurance contributions is an alluring prospect and represents a step in the right direction, but suffers from two important defects I feel. First, if we want to improve the equity of the tax system health contributions should be the last benefit to fully or partially tax, not the first. The reason again is that health contributions alone among voluntarily provided fringes are distributed roughly proportionally.

The second defect of capping health contributions alone—or any single contribution alone—is that such an approach opens the door to tax avoidance by substitution away from the newly taxed benefit and towards still untaxed benefits. Such substitution is more than merely an academic matter. It means the existing estimates of revenue gains resulting from taxing health contributions may be too high. I should mention we have no microeconomic evidence at this point on the degree to which pensions and health insurance are substitutes. But developing such estimates should be a high priority for research.

In short, to mitigate inequities in the present system a uniform tax treatment of all benefits is required. Also, based on my own research and that of others I am unconvinced that taxation of employer contributions would result in disappearance or even reduction of fringe benefits.

I would therefore advocate a limit on the proportion of total compensation that could be provided without Federal payroll or personal income taxation. This plan is similar to the second part of the Munnell proposal, and it has three advantages. First, it is comprehensive. Second, it focuses on the proportion of total compensation, and so would obviate the wrangling that has taken place over dollar sum caps on tax-free contributions to health insurance. Finally, it would have a minimal effect on workers and their benefits while it would forestall further erosion of the tax base.

Thank you.

Chairman PICKLE. Thank you.

[The prepared statement follows:]

STATEMENT OF STEPHEN A. WOODBURY, SENIOR RESEARCH ECONOMIST, W.E. UPJOHN INSTITUTE FOR EMPLOYMENT RESEARCH*

THE TAX TREATMENT OF FRINGE BENEFITS: WHAT DO WE KNOW AND WHAT NEEDS TO BE LEARNED?

The rather frivolous appelation that has been given to nonwage benefits—"fringe" benefits—tends to mask both the importance of these benefits to workers and the far-reaching implications of their favored tax status. For it is difficult to think of health care or retirement income plans as merely decorative, peripheral, or frilly parts of the compensation package in an age when health services account for over five percent of national income and when over eleven percent of the population is aged 65 or more. And further, the employer-provision of these benefits affects a multitude of economic outcomes and behavior: the distribution of income and the equity of that distribution; the size of the income and payroll tax bases and the equity of the tax system; the use (or overuse) of the health-care system and the timing of retirement.

What follows is a necessarily selective review of the burgeoning economic research on nonwage benefits—specifically private pensions and health-insurance plans—and an equally selective summary of the lacunae in that research. The focus is on a few questions that are of immediate importance to policy: How much have nonwage benefits grown and why? Who is covered and what are the implications of the existing pattern of coverage for income distribution? What changes in the tax treatment of nonwage benefits would yield significant revenue gains, and what are the implications of these changes for the equity of the tax system? What are some of the significant effects of employer-provision of benefits on workers' behavior and how do these induced behaviors affect in turn other economic outcomes?

HOW MUCH, AND WHY, HAVE FRINGE BENEFITS GROWN?

It is by now a commonplace observation that nonwage benefits voluntarily provided by employers have grown dramatically in the post-World War II period. The Bureau of Economic Analysis estimates that voluntary nonwage benefits (that is, "other labor income," which includes employer contributions to all voluntary funds such as pensions, profit-sharing, group health and life, workers' compensation, and supplemental unemployment) rose from 2.3 percent of private sector total compensation in 1948 to 10.3 percent in 1982.[1] For the sample of companies surveyed by the Chamber of Commerce, voluntary contributions to pensions, health insurance, and

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[*] The views stated here are those of the author and do not necessarily represent the views of the W.E. Upjohn Institute.

[1] U.S. Bureau of Economic Analysis, The National Income and Produce Accounts of the United States (Washington, D.C.: U.S. Government Printing Office, 1981), Tables 6.15 and 6.6B and Survey of Current Business 63 (July 1983), Tables 6.15 and 6.6B. For these purposes, total compensation is defined as the sum of wages and salaries and other labor income—that is, excluding contributions to social insurance. (Social insurance contributions are included in the income and product accounts' measure of "compensation" in Table 6.5 of the accounts.)

other "agreed upon" items rose from about five percent of total compensation in 1951 to 11.6 percent in 1982.[2]

In large part, these increases have been in the form of contributions to retirement and (particularly) health-insurance plans—whereas about 60 percent of voluntary contributions were in the form of retirement and health benefits in 1948, nearly 84 percent of voluntary contributions were for retirement and health benefits in 1982.[3]

Although no one disputes the enormous of nonwage compensation, there is less certainty about the causes of this growth. The litany of reasons for the provision of fringe benefits includes: preferential treatment under the federal personal and corporate tax codes; economies of scale in the provision of pensions and insurance; efforts to improve workers' productivity and reduce turnover by deferring payment of benefits; unionization; changing demographic composition of the labor force; and rising real incomes.[4]

To what degree can each of these factors explain the growth of fringe-benefit provision? Although there is substantial evidence that unions and collective bargaining exert a positive independent effect on the provision of nonwage benefits, the stagnation of private-sector union growth since the 1950s makes unionism an unikely source of the recent growth of fringes.[5] Similarly, it is unclear that the "technology," so to speak, of benefit provision has changed so as to yield scale economies of benefit provision where none existed before. That is, it may well be that more employers are taking advantage of the lower costs that result from group purchases of pensions and health benefits, and also that pension and insurance providers are reducing overhead and administrative costs by expanding their asset or risk pools—but these changes should probably be viewed as responses to an increasing demand for benefits rather than as autonomous forces causing that increase.[6]

Deferral of income has been shown quite convincingly to reduce labor turnover, and by reference, to improve productivity.[7] But again it is unclear that the desire to reduce turnover has been important to the growth of nonwage benefits. The only existing study of this question concludes that considerations of productivity and turnover are far less potent explanators of pension growth than is the tax treatment of pension contributions.[8]

The most likely causes of fringe-benefits growth, then, are the aging of the labor force, favorable tax treatment of benefits, and rising real incomes (that is, increases in income apart from the implications such increases have for the tax rates faced by households). Several studies have confirmed the influence of all three of these factors on fringe-benefit expenditures and the share of total compensation received as fringe benefits.[9] In particular, increases in the marginal tax rate on wage income and increases in households' real incomes have been found to have strong positive influences on the provision of health, life, and pension benefits.

That several independent researchers using various data sources and somewhat varying techniques should all arrive at similar conclusions is fairly persuasive. But I would like to sound at least one warning about the interpretation of these results, lest they be misconstrued. It should not be inferred from these studies that rising marginal tax rates are the only, or even the most important, cause of fringe-benefit growth. Correspondingly, it should not be inferred that if the favorable tax treatment of fringes were abolished then fringe-benefit plans would disappear. I feel it is important to make these points because I am less confident than some that we have successfully separated the effects of rising incomes from the effects of rising marginal tax rates on fringe provision. Not only have incomes and tax rates grown together over time, but also in cross-section there is a close relation between the income and the marginal tax rate faced by a household. This close relation poses problems for econometric estimation. Although together, rising incomes and rising marginal tax rates on wages income have surely accounted for most of the recent increases in fringe benefits—my own estimate is that they account for nearly two-thirds of the increase [10]—it would be premature to say that rising marginal tax rates rather than (pure) rises in income are the main factor.

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[2] Chamber of Commerce of the United States, Fringe Benefits 1951 (Washington, D.C.: Chamber of Commerce, 1952), Table 3, p. 9; and Chamber of Commerce of the United States, Employee Benefits 1982 (Washington, D.C.: Chamber of Commerce, 1984), Table 4, p. 8. Figures in the text equal "pension, insurance, and other agreed upon payments" as a percentage of gross payroll plus pension, insurance and other agreed upon payments. Thus, legally required payments are excluded, and rest periods and other payments for time not worked are included as part of the wage. The Chamber of Commerce sample started out as a rather selective high-benefit sample, and has become more representative over the years. Note that, unlike the National Income and Product Accounts, profit-sharing is not lumped with pension contributions in the Chamber of Commerce data.

[3] Table 6.15 in the National Income and Product Accounts and in Survey of Current Business.

[4] See Rice (1966), Lester (1967), and Long and Scott (1982) for general discussions. The issue of improving productivity and reducing turnover—the so-called agency motive for providing deferred benefits—have been treated by Logue (1979) and Lazear (1981).

[5] See, among others, Freeman (1981), Alpert (1982), Rossiter and Taylor (1982), and Fosu (1984), and Mincer (1981). Freeman and Mincer differ sharply on the underlying causes of the union nonwage benefit effect.

[6] Mitchell and Andrews (1981) offer an empirical treatment of scale economies of pension provision.

[7] Schiller and Weiss (1979) and Wolf and Levy (1984).

[8] Mumy and Manson (1983).

[9] Alpert (1983), Atrostic (1983), Leibowitz 1983), Long and Scott (1983), Sloan and Adamache (1983), Taylor and Wilensky (1983), Turner (1981), Vroman and Anderson (1984), and Woodbury (1983).

Will pension and health contributions continue to grow as a proportion of total compensation? My own conjecture is that they will, under the status quo or any change in tax treatment that is under serious consideration. But the growth will almost surely be less dramatic than it has been in the past. Although the calculations leading to this guess are best religated to a footnote,[11] the intuition behind the guess is straightforward: Consider two workers with equal total compensation. One has some promised retirement income whereas the other has none. The worker who already has some retirement income will be less willing to exchange additional present income for more retirement benefits than will the other. Thus, as the coverage and level of pension plans (and social security) have increased, more workers have become less willing to trade additional income today for additional retirement income.[12] The market for certain nonwage benefits is, in effect, becoming saturated.[13]

FRINGE-BENEFIT COVERAGE AND INCOME DISTRIBUTION

Fringe benefit coverage and payments made by employers vary greatly by industry, occupation, sex, and race. Transportation, manufacturing, and mining have been historically high-benefit industries, whereas services, trade, and construction have offered relatively low benefits.[14] Among occupations, the high-benefit occupations are as one might expect: managers and administrators, professional and technical, craft workers, and certain operatives. Service, sales, and clerical occupations are, also expectedly, the low-benefit occupations. Even among full-time and full-year workers, women receive lower benefits and are less likely to be covered than men. As for black-white differentials, blacks are somewhat less likely to be covered by health insurance and pension benefits (34.8 percent for blacks, 38.2 percent for whites), and fringe benefits make up a smaller proportion of black than of white workers' total compensation.[15]

As a whole, voluntary employer-contributions to pensions and to health and life insurance tend to make the distribution of income more unequal: High-wage workers receive a larger share of their total compensation as deferred income and insurance than do low-wage workers.[16] But it is important to decompose total compensation into health and life insurance, on the one hand, and pensions and other deferred compensation, on the other. The reason is that health and life insurance benefits are roughly proportionately distributed (Smeeding found that insurance benefits ran from 3.7 percent of compensation for low-wage workers to 6.2 percent for a middle-wage group, and then declined to 2.9 percent for the highest earnings group) whereas deferred compensation is highly regressively distributed (0.4 percent of compensation for the lowest earnings group to 7.2 percent for the highest).

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[10] See p. 180 of my 1983 paper.

[11] The response to a change in the price of wage benefits can be decomposed by the Slutsky equation as follows:$e=(k_w)(s)-(k_w)(s)$, where e is the elasticity of demand for fringes with respect to a change in the price of wages, k_w is the share of compensation received as wages, s is the eleasticity of substitution between wages and fringes, and e is the income elasticity of demand for fringes. Estimates of s and e are such that as the wage share of total compensation (k_w) falls, e also falls. (See the estimates in my 1983 paper.)

[12] Even if the terms of trade between present income and retirement income continue to improve (through increasing marginal taxes on income, coupled with exemption of pension contributions), given proportional improvements in those terms of trade will elicit ever smaller responses from workers.

[13] Munnell (1984) comes to the same conclusion for pension and health benefits by a slightly different route.

[14] Calculations from The National Income and Product Accounts, op. cit.; and Survey of Current Business (July 1983).

[15] See Smeeding (1983), tables 6.2 and 6.3. This discussion depends heavily on Smeedings' useful paper.

[16] Again, see Smeeding (1983), Tables 6.6 and 6.7. Smeeding's findings are corroborated by the findings of Taylor and Wilensky (1983) for health benefits, and of Kotlikoff and Smith (1983) for pensions.

[17] Munnel (1984), pp. 21-22.

In contrast, legally required contributions, such as social security, unemployment insurance, and workers' compensation tend to be progressively distributed and bring about greater equality.

In sum, voluntarily provided fringe benefits, unlike legally mandated contributions to social insurance, seem to have a disequalizing influence on income distribution. This naturally raises questions about the desirability of exempting these benefits from federal payroll and personal income taxes.

EQUITY OF THE TAX SYSTEM AND REVENUE LOSSES RESULTING FROM FRINGE EXEMPTIONS

If a larger proportion of the total compensation of high-earnings workers is received as nonwage benefits, as appears to be the case, then the exemption of those benefits from payroll and personal income taxes is clearly a regressive aspect of the tax system. That is, exemption of nonwage benefits violates the vertical equity precept that those with greater ability to pay for government services should do so.

In addition, exemption of nonwage benefits creates situations where horizontal inequities can—and undoubtedly do—arise. Consider two individuals, each with total compensation (wages plus contributions to health insurance, life insurance, and pensions) of $20,000. Suppose also that they are both single and declare one exemption and the zero-bracket amount. If Smith receives $17,000 in wages, while Jones receives $18,500 in wages, then Jones pays more taxes and faces a higher marginal tax than Smith. But this clearly violates the precept of horizontal equity—that households equally situated should be taxed equally.

The "pure solution" to this problem, as Munnell has called it, is to include all employer contribution for employee benefits in taxable gross income. (Increases in accrued pension contributions would also be included in gross income, since such increases constitute an increase in an individual's lifetime income.) The pure solution is attractive both in principle—it would mitigate inequities in the tax system—and in the practical sense that it would either raise federal revenues or permit federal marginal income and payroll tax rates to be lowered.[18] The practical difficulties of implementing this pure approach are minimal. Indeed, those problems that exist pale beside the political opposition such a proposal would almost certainly meet. In view of this potent potential opposition, some workable alternative must be sought.

One alternative that has gained currency, and has been introduced in a variety of guises in legislative proposals, is to limit the amount of the employer's contribution to health insurance that is excluded from the worker's taxable gross income.[19] Such an approach would stem what many observers believe to be an inefficient and excessive use of the health care system which has led to inflation in that sector, and would also raise considerable revenues.[20]

Placing a tax cap on health contributions has some alluring features, and represents a step in the right direction, but the approach also suffers from two important defects. First, if we want to improve the equity of the income tax system, health insurance contributions should be the last benefit to fully or partially tax, not the first. As noted above, insurance contributions, alone among voluntarily provided fringes, are distributed roughly proportionately. Thus, taxing them would not serve to improve the vertical equity of the tax structure—in fact, calculations by Taylor and Wilensky show that the effects of a tax ceiling on health contributions would be felt disproportionately by lower-income groups.[21]

The second defect of placing a tax cap on health contributions alone (or on any single benefit alone) is that such an approach still leaves contributions to other nonwage benefits untaxed, and hence opens the door to tax avoidance by substitution away from the newly-taxed benefit and toward other still-untaxed benefits. Such substitution is more than an academic matter—it means that the estimates of revenue gains that would result from taxing health contributions may be too high. It should be emphasized that we have no knowledge of the degree to which substitution from health benefits into pension benefits would take place—no study has yet attempted such measurement.[22] But it is clear that the appeal of a tax-cap on health contributions would wane substantially if the possibilities for substitution between health and pension benefits are strong.

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[18] Munnell (1984, table 2) estimates the revenue gain from such a comprehensive tax to be $64.3 billion in 1983.

[19] Sullivan and Gibson (1983) discuss the details of these proposals.

[20] See Taylor and Wilensky (1983) for some estimates of the potential revenue gains.

[21] Taylor and Wilensky (1983), table 9-7, p. 177.

SUMMARY AND DISCUSSION

Several studies have found that the growth of fringe benefits is accounted for largely by the favorable tax treatment they have received, by increases in real income, and by the going of the labor force. Although most of these studies have made much of the influence that favorable tax treatment and increasing marginal tax rates have had on benefit growth, it would be a mistake to believe that tax treatment is the only cause of fringe-benefit growth, and an even greater mistake to believe that fringes would vanish if the favorable tax treatment were removed. Insurance and pension plans are a better buy when purchased through the employer, the institutions to provide benefits efficiently are in place, the work force will continue to age, employers will still make use of deferred benefits as a means of reducing turnover, and real income will continue to rise—for all these reasons, removing the favorable tax treatment of benefits would not kill the goose that laid the golden egg and lead to the demise of employer-provision of health and retirement benefits.

In addition, equity and fairness in the distribution of income and the distribution of the tax burden suggest the expedience of taxing benefits. Pensions and other deferred compensation in particular lessen the equality of the distribution of income, so that the failure to tax employer contributions to pension plans violates the ability-to-pay or vertical equity principle of taxation. Also, since individuals with similar levels of total compensation may receive quite different mixes of wage and nonwage benefits, the failure to tax nonwage benefits introduces horizontal inequities into the tax system.

Full or partial taxation of a single specific benefit (such as health-care contributions) is an unattractive alternative to full or partial taxation of all benefits, because of the possibility that employees could substitute away from the newly taxed benefit and into still-untaxed benefits (such as pensions). Thus, taxation only of health contributions would not greatly improve the equity of the tax system. Neither, it seems likely, would it raise the amounts of revenue that have been promised, as workers and employers would make adjustments in the benefits package so as to avoid taxation. Finally, taxation of a single benefit would fail to correct fully the resource misallocation that has resulted from sheltering fringes from taxation—all have in effect been subsidized forms of compensation in the past, and an even-handed approach to their taxation is needed to mitigate the distorting effects of the current system.

Munnell (1984) has discussed several alternatives to comprehensive and full income and payroll taxation of all employer contributions for fringes. Her suggested "perhaps palatable" alternative, which would limit the proportion of total compensation that an employer could contribute without taxation, has at least three advantages. First, it is comprehensive, treating all benefits equally. Second, its focus on the proportion of total compensation obviates the sort of wrangling over dollar-sum caps than has accompanied proposals to limit tax-free contributions to health insurance. And third, it would have a minimal (if any) immediate effect on workers and their benefits, while forestalling further erosion of the tax base. Some such solution is greatly needed to redress the resource misallocations and inequities that the favored tax status of fringe benefits have generated.

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Chairman PICKLE. Our final panelist is Gail Wilensky, director, Center for Heath Affairs, and vice president, Domestic Division, Project HOPE.

STATEMENT OF GAIL R. WILENSKY, VICE PRESIDENT, DOMESTIC DIVISION, PROJECT HOPE

Ms. WILENSKY. I am vice president of the Domestic Division of Project HOPE. I am pleased to have this opportunity to speak to you about the effects of statutory exclusions of certain fringe benefits, particularly employment related health insurance. Much of the information I will present is based on work done while I was at the National Center for Health Services Research, which I have continued at Project HOPE. I am, of course, speaking for myself and not for either of these organizations. I would like to submit my written testimony for the record.

We have been asked how large the subsidy is and how large the fringe benefit is. I am focusing on employment related health benefits and do have information about its growth. These contributions have grown from about $36 billion in 1977 to almost $80 billion in 1983.

There have been two major concerns regarding the current tax treatment of employer contributions to health benefits, and we have been hearing them this morning. First, it has resulted in large revenue losses to the Federal Treasury and government organizations at the State level. Related to these are certain equity issues. Second, and of particular concern to health policy analysts, the current tax treatment has provided an incentive to purchase additional amounts of health insurance, which, in turn, results in increased levels of health expenditures.

The loss in revenues to the Federal Government and to other governmental levels which have resulted from this exclusion has been estimated to be about $31 billion in 1983, up from about $12 billion in 1977. This includes losses to the Federal income tax, to FICA, and also to the State income tax.

In answer to the question of who receives employee health benefits, we have heard this morning that many people do. Approximately 85 percent of private health insurance is employment related. The vast majority of employees, about 90 percent, work for firms which offer health insurance plans. The most important characteristics of firms which do not offer health insurance are their small size and relatively large percentages of low wage employees on the payroll. Generally, firms that provide employment related health insurance provide it to all of its employees.

Contributions by employers have also been increasing rapidly, up from $623 in 1977, on average, to $1,126 in 1983. The share of the premium paid by the employer is substantially higher for certain employees, particularly those in firms with some union representation, and lower in firms which are in the South. While the share of the premium paid by the employer does not vary with employee income, the average contribution of the employer does in fact increase slightly with employee income.

So, although we have heard this morning from several people that treatment of employer contributions are not proportional to income, there is in fact some slight correlation between the two. In table 2, average employer contribution by income level is shown, and in an appendix I have included information about the distribution of different amounts of employer contributions by family income. So while it is correct that employer contributions are not very influenced by income but there is some positive relationship by income.

The question of who receives the subsidy, however, makes the relationship with income much more important. That is, while the premium itself only varies slightly with income, distribution of the tax subsidy is much more unequal with respect to income. In general, those in higher tax brackets receive a greater subsidy than those in lower tax brackets and the reason is that the amount of the current exclusion of the employer contribution depends on the employee's income tax rate. The higher the income, the higher the marginal tax rate. And these higher marginal tax rates produce greater savings.

The average savings from Federal income tax in 1983 was estimated to be $332 from this exclusion, but it varied substantially by family income. And I have estimates provided in the paper in Table 3. There are two basic reforms that have been mentioned with respect to health insurance, and then a third reform which I would like to touch on briefly.

The two major reforms which would make all or a portion of the employer-provided health insurance subject to taxation involve either a specific dollar tax cap or flat excise tax. There have been a number of proposals, as you know, before Congress which have required employees to include all or a portion of the employer-provided health insurance in their taxable income. The Reagan administration proposed a tax cap of $2,100 for family coverage and $840 for individual coverage. The number of employees affected and amount of revenue at risk depends on where the cap is placed. Estimates range from having as many as 62 million subscribers affected and bringing in $31 billion—if the full employer contribution was taxed to raising $2.3 billion and affecting 11 million subscribers—if the tax cap was as high as $2,400 for families.

Additional information on the amount of revenue and number of subscribers which would be affected is included in my paper. Another option in addition to the tax cap is the excise tax. The excise tax could be imposed on employer payments for health insurance, and it could be set as a variety of rates as we have just heard. One attempt might be to set it to proxy the effect of the tax cap and to set it at a rate which would provide revenue equal to that at 11 percent, the lowest income tax rate for individuals.

While this would mean that high-income individuals would receive a greater subsidy than low-income individuals, assuming—as economists would—that the tax would be passed back to employees, the difference would be not as great as it is under the current exclusion. The third option, and one which we have heard about this morning, is to place a tax cap or an excise tax on all fringe benefits rather than attempting to limit expenditures on any specific fringe benefit such as health insurance.

I would like to talk for a few minutes about the incentive and equity effects of the current tax treatment.

The equity concern, as we have heard, is that the exclusion is worth more, the higher the taxpayer's taxable income. Taxing all or a portion of this fringe benefit would broaden the tax base, and would remove at least some of the least desirable equity effects of the income-related subsidy.

It should be noted, however, that because employer contributions do not vary much with income, the additional taxed amount under a tax cap would actually represent a somewhat larger percentage of a low-income individual's income than that of a higher income individual. That may sound somewhat contradictory to the statement that the current subsidy is worth more the higher the individual's income, but it happens because although the marginal tax rate for low-income individuals is lower, the amount taxed under a tax cap requests a higher percentage of total income.

Equally important, however, is the fact that the tax cap would encourage employees and employers to choose efficient health care plans, particularly the lower cost plans with high deductibles, and co-insurance provisions. Individuals who wanted comprehensive coverage would be encouraged to choose innovative health care delivery systems such as health maintenance organizations. The incentives to become much more cost conscious should result in lower health care costs.

Estimating how a tax cap would actually affect health care expenditures is much more difficult than estimating the revenue effects. Some estimates are provided in this paper, but I think we have to understand that they are in fact not likely to be very precise. It should, however, make consumers more cost conscious in their choice of providers and health care plans, and this is an important provision in health care and in health insurance, as opposed to the other fringe benefits which we have been considering.

The use of an excise tax to be paid by employers would make employers more cost conscious with respect to the health plans chosen for their employees. Since we expect that the excise tax would be shifted back to employees, it would have an incidence similar to taxing all employees at exactly the same marginal tax rate. This would improve equity but be less satisfactory in my view than including the income in the employee's own taxable income.

There are, however, two appealing characteristics of an excise tax. It does solve the problem of how to allocate employer payments to individual employees, particularly when the employee self-insures, and it may be perceived as more of a tax on business and less of a tax on employees, and therefore be politically appealing. Aside from these considerations, however, in my view the tax cap represents a preferred option on both equity and efficiency grounds

During the 1976's and 1970's most of the changes in employment-related health insurance coverage were directed toward extending coverage to new benefits and new beneficiaries. Two events have contributed to a change in the direction of employee benefits over the past few years.

First, the recession which began in the early 1980s has put a squeeze on employer profits. Second, health care costs continue to increase at a pace which far exceeded costs in other sectors of the economy, even when other cost increases began to moderate. These two events taken together have increased employers' awareness of the effects which health care costs can have on their discretionary expenditures. As a result, they have engaged in a variety of initiatives to contain health care costs, including forming coalitions, helping to enact support of legislation, and redesigning health insurance benefits.

Because of the time it takes to collect nationally representative data, it is difficult to know with any precision the scope and magnitude of the changes which have been taking place over the last two years. It does appear, however, that employes are engaging in a variety of activities which are lowering their health care costs. According to a survey of some 1,500 organizations including the Fortune 1,000, conducted by the Health Research Institute in California, over 35 percent of the employers have increased the deductible for family and individual coverage, and almost 19 percent had increased employee co-insurance contributions.

In addition, 25 percent were insuring that the rates were applied accurately, almost 20 percent were engaging in either concurrent or retrospective utilization review, and about a third were requiring second opinions.

While the nonrepresentative nature of the sample and the 40 percent response rate make it difficult to generalize these findings, a report by Hewitt Associates of some 25 major U.S. employers, suggests similar activities. They reported that between 1979 and 1983 there was a substantial decline in the number of companies with deductibles as low as $100, and a substantial increase in the number of companies with deductibles over $150.

Some employers have argued that since these initiatives have occurred in the absence of a tax cap, tax caps are not needed to stimulate cost-conscious behavior by employers and employees. I think that this opinion may be overly optimistic. Aside from the revenue and equity issues which are clearly important, it is not clear what will happen to benefits as we continue to come out of the current recession.

Employees who saw their benefits scaled back during the recession, with increased unemployment, may wish to recapture some of the benefits they have given up. Even if that does not occur, it is better to have both employers and employees more cost-conscious about their choice of health plans than just the employers.

The conclusion of my testimony is that the effect of the current tax treatment on employment-related health insurance has been to erode the tax base, to cost the Treasury approximately $30 billion in revenue, to provide a subsidy which is worth more as the taxpayer's income increases, and which encourages the purchase of additional health insurance.

The arguments for limiting the tax-free nature of employment-related health insurance are even stronger for health benefits than they are for other fringe benefits. Subsidizing the purchase of pension benefits and life insurance is now thought to exacerbate the expenditures in these areas, whereas increased health insurance is regarded as a major cause for increased spending in the health area. Despite this fact, the tax cap has proven to be politically unattractive and has been roundly attacked by business, labor and the insurance industry, as I know you have heard.

An alternative to limiting health insurance expenditures would be to place a limit on the amount of fringe benefits which employees can take tax-free. Having employees think of their fringe benefits as a pool of benefits which can be taken tax-free up to a specified limit would encourage them to be more aware of the competing use of these tax-free funds. Since expenditures on employment-related health insurance are currently tax free, an overall limit could only reduce the amount currently spent on employment-related health insurance.

[The prepared statement follows:]

Statement of Gail R. Wilensky, Vice President, Domestic Division, Project HOPE, Millwood, VA*

Mr. Chairman and Members of the Subcommittee, I am pleased to have this opportunity to speak to you about the effects of statutory exclusions of certain fringe benefits, particularly employment related health insurance. Much of the information I will present is based on work done while I was at the National Center for Health Services Research and continued at Project HOPE, where I am currently the Vice-President of the Domestic Division and Director of its Center for Health Affairs. The opinions I express, however, are my own and should not be attributed to either of these organizations.

EMPLOYER PROVIDED HEALTH INSURANCE: INCENTIVE AND EQUITY ISSUES

Employment related health benefits: How large is the subsidy

There are several employee benefits which receives preferential treatment. These include retirement, health, disability, and life insurance plans, as well as workers compensation. The total amount of benefits has been rising over the past few years: in 1981, employer contributions to such plans were estimated to equal 13.5 percent of wages and salaries, up from 5.9 percent in 1970.*(1)* The focus of my comments, however, is on employment related health benefits.

The total amount of employment related health benefits has also been rising over the past few years. Employer contributions for health benefits were approximately $77 billion in 1983, compared to about $36 billion in 1977. There are two major concerns regarding the current tax subsidy of employer contributions to health benefits. First, it has resulted in large revenue losses to the U.S. Treasury and, to a lesser extent, state governments. Second—and of particular concern to health policy analysts—the reduced price of health insurance via the subsidy has provided an incentive to purchase additional amounts of health insurance, which in turn results in increased levels of health expenditures.

The tax treatment of employer contributions to health insurance coverage is preferential because such contributions are excluded from employees taxable income and the earnings to which payroll taxes are applied. The loss in government revenues stemming from this exclusion was estimated to be approximately 31 billion dollars in 1983, up from 12 billion in 1977.*(2)*

TABLE 1

	1977	1983
Federal income tax	$8.5	$20.5
FICA	2.0	6.5
State income tax	1.5	3.7
Total taxes	12.0	30.7

Source: Wilensky and Taylor (1982), Taylor and Wilensky (1983).

Who receives employee health benefits?

Recent estimates indicate that almost 85 percent of private health insurance is employment related. Furthermore, the vast majority (more than 88 percent) of employees work for firms which offer health insurance plans. The most important characteristics of firms which do not offer health insurance is that they tend to be small (less than 25 employees), and have a relatively large percentage of low wage employees on the payroll. In firms that provide employment related health insurance, almost all employees (94 percent) are eligible for such insurance. This percentage does not vary by employer characteristics.*(3)*

The average employer contributions was $1126 in 1983, up from $623 in 1977. The percent of the premium paid by the employer was substantially higher in firms with some union representation, 89 percent versus 73 percent of the premium for firms with no union representation. The percentage paid by employer was substantially lower in the South (72 percent) than it was for the country as a whole (80 percent). Although the share of the premium paid by employer does not vary with employee income, the average contribution by employer increases with subscriber family income, as shown in Table 2. The relationship, however, between employer contribution and family income is not very strong. The distribution of employer contributions by family income is shown in Appendix Table A.

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* The author would like to thank Steven Chapman, research assistant at Project HOPE, for valuable assistance in preparing this testimony.

TABLE 2.—AVERAGE EMPLOYER CONTRIBUTIONS, EMPLOYEE CONTRIBUTIONS, AND TOTAL PREMIUMS FOR GROUP SUBSCRIBERS, BY FAMILY INCOME, 1983

Family income	Total number of subscribers (thousands)	Average contribution by employer [1]	Average contribution by employee	Average total premium [2]
$1 to $9,999	$4,263	$763	$295	$1,071
$10,000 to 14,999	5,665	855	304	1,170
$15,000 to $19,999	7,499	1,025	330	1,371
$20,000 to $29,999	17,045	1,098	343	1,466
$30,000 to $49,999	23,076	1,287	315	1,626
$50,000 or more	10,979	1,188	288	1,443
Total [3]	68,627	1,126	317	1,466

[1] Includes those with zero employer contributions.

[2] Employer and employee contributions do not add to total because of "other" contributions.

[3] Includes persons with income less than $1.

Source: National Center for Health Services Research, National Medical Care Expenditure Survey, unpublished data.

Who receives the subsidy?

The distribution of the employment related health insurance tax subsidy is much less equal with respect to income than is the distribution of employer contributions. In general, those in higher tax brackets receive a greater subsidy than those in lower tax brackets. The reason is that the amount of the current exclusion of the employer contributions depends on the employees taxable income—higher incomes are associated with higher tax rates, and higher marginal tax rates produce greater savings. Most employees with employment related health insurance receive savings from Federal or state income taxes, but only a small number of lower income employees also receive savings from Social Security taxes. The average savings from federal income tax was $332 but the average varied substantially by family income. The average savings in total tax was $467 but this average also varied substantially. These figures are shown in Table 3.

TABLE 3.—NUMBER OF SUBSCRIBERS AFFECTED AND THE AVERAGE TAX SAVINGS FROM EXCLUDING EMPLOYER CONTRIBUTIONS BY INCOME CLASS, 1983

Family income	Number of subscribers affected (thousands)	Average in Federal income tax [1] saving	Average in total tax saving [1] [2]
I. No exemptions:			
$1 to $9,999	3,145	$105	$174
$10,000 to 14,999	4,788	161	242
$15,000 to $19,999	6,650	213	317
$20,000 to $29,999	15,547	277	394
$30,000 to $49,999	21,384	420	552
$50,000 or more	9,984	464	576
Total [3]	61,575	332	467

[1] Excludes subscribers not affected by any tax change.

[2] Excludes employers' share of FICA.

[3] Includes persons with income less than $1.

Source: National Center for Health Services Research, National Medical Care Expenditure Survey, unpublished data.

Tax reform options

The major option for tax reform is to make all or a portion of the employer provided health insurance coverage subject to taxation. Two suggestions are a specific dollar tax cap, and a flat excise tax.

Tax cap

There have been a number of proposals before Congress which required employees to include all employer related health insurance above a specified amount in their taxable income. The Reagan Administration proposed a tax cap of $2100 for family coverage and $840 for individual coverage. The number of employees affected and the amount of tax revenue at risk varies substantially according to where the tax cap is placed. If, for example, all employment related insurance had been taxed in 1983 (i.e., the tax cap set at zero), then 62 million subscribers would have been affected and the *total revenue collected would have been $31 billion.* A tax cap as high as $2400 for family coverage and $975 for individual coverage would affect 11 million subscribers and, in 1983, raise $2.3 billion. The Administration's proposal was projected to affect 16.5 million subscribers and raise approximately $3.1 billion. Additional information on the number of subscribers affected and the increase in tax revenue by type of tax is presented in Appendix B. Additional information on the impact of various tax caps on employee income is available elselwhere.(*4*)

Excise tax

The second major option is to impose an excise tax on employer payments for group health insurance. The excise tax could be set at a variety of rates depending on the amount of revenue one wished to raise. It also could be set to proxy the effect of a tax cap. For example, the rate might be set at 11 percent, which is the first bracket rate for the individual income tax. While this would still mean that high income individuals would receive a greater subsidy than low income individuals (assuming that the tax were passed back to employees), this difference would not be as great as before.

An additional option would be to place the tax cap or the excise tax on total fringe benefits rather than attempting to limit expenditures only on specific fringe benefits such as health insurance.

Incentive and equity effects

Concern about the current tax treatment of health insurance benefits has involved both the equity effects as well as the incentives it provides for the purchase of additional health insurance. The equity concern is that the exclusion is worth more as the taxpayer's taxable income increases, and is worth very little for employees at the lowest income levels. Taxing all or a portion of this fringe benefit would broaden the tax base and remove at least some of the less desirable aspects of this income related subsidy.

It should be noted, however, that because employer contributions do not vary much with income, the additional tax would actually represent a somewhat larger share of a low income individuals income than that of a higher income individual. Equally important, the tax cap should encourage employees and employers to choose efficient health care plans, particularly the lower cost plans with high deductibles and co-insurance provisions. Individuals who wanted comprehensive coverage would be encouraged to choose innovative health care delivery systems such as HMOs. The incentives to become more cost conscious should result in lower health care costs.

Projecting the impact of a tax cap on health care expenditures is much more difficult than projecting the revenue effects of tax caps. In a 1983 study done with Amy Taylor, we predicted a decline in total premiums ranging from $7.5 billion to $1.8 billion as a very conservative estimate and a decline of $16.7 billion to $3.6 billion as a more likely estimate. The ranges reflect different limits which might be chosen for the tax cap. While the precise reductions are difficult to estimate, a tax cap would make consumers more cost-conscious in their choice of providers and health care plans, which may result in greater reductions in health insurance expenditures than we have projected. While the tax cap would send the strong signal to both consumers and providers, it would take time for the system to respond to the increased awareness of health care costs.

The use of an excise tax to be paid by employers would make them more cost-conscious when choosing health plans for their employees. Since it could be expected that the excise tax would be shifted back to the employees, it would be similar to taxing all employees at that marginal rate. This would improve equity, but be less satisfactory than including the income in the employees own taxable income. There are, however, two appealing characteristics of the excise tax. First, it solves the problems of allocating employer payments to individual employees when the employer self-insures. Second, it may be perceived as more a tax on business and less of a tax on employees, and therefore be more politically appealing. Aside from these two considerations, however, the tax cap represents a preferred option on both equity and efficiency grounds.

Recent employer initiatives

During the 1960s and 1970s, most of the changes in employment related health insurance coverage extended coverage to new benefits and new beneficiaries. Since then, two events occurred which contributed to the change in the direction of employee benefits which has been occurring over the past few years. First, the recession which began in the early 1980s put a squeeze on employer profits. Second, health care costs continue to increase at a pace which far exceeded costs in other sectors of the economy and show little sign of reaching any plateau, despite the fact that other cost increases began to moderate. These two events taken together have increased employers' awareness of the effects which health care costs can have on discretionary expenditures. As a result, they have engaged in a variety of initiatives to contain health care costs including forming coalitions, helping to enact supportive legislation and redesigning health insurance benefits.

Because of the time it takes to collect nationally representative data, it is difficult to know with any precision the scope and magnitude of the changes which have been taking place over the past two years. Most of the information which is available is ancedotal or based on selected groupings of industries. Nonetheless, it is clear that employers are engaging a variety of activities which are designed to lower their health care costs. According to a survey of 1500 organizations including the Fortune 1000 conducted by the Health Research Institute in California, over 35 percent of the employers have increased the deductible for family and individual coverage, and almost 19 percent had increased employee coinsurance contributions. In addition, 25 percent of the firms were ensuring that the coinsurance rates were accurately applied, almost 20 percent were engaging in concurrent or retrospective review, and approximately 35 percent were requiring second opinions. While the nonrepresentative nature of the sample and the 40 percent response rate make it difficult to generalize these findings, a report by Hewett Associates for some 250 major U.S. employers for the period 1979 through 1983 appears to suggest similar activities. For example, they report a substantial decline in the number of companies having deductibles under $100 and a substantial increase in the number of companies having deductibles over $150 per year. Simiarly, the use of a stop loss feature (which limits the out-of-pocket expenses of an employee) increased from 57 percent in 1979 to 78 percent in 1983.

Some employers have argued that since these initiatives have occurred in the absence of a tax cap, tax caps are not needed in order to introduce additional cost conscious behavior on the part of employers and employees. I think this opinion may be overly sanguine. Aside from the revenue and equity issues, it is not clear what will happen to benefits as we continue to come out of the current recession. Employees who were willing to see their benefits scaled back during a recession with increased unemployment, may wish to recapture some of the benfits they have given up. Even if that does not occur, it is better to have both employers and employees more cost conscious about their choice of health plans than just employees.

CONCLUSION

The effect of the current tax treatment of employment related health insurance is to erode the tax base, cost the Treasury approximately 30 billion dollars in revenue, provide a subsidy which is worth more to the taxpayer as that taxpayer's income increases, and encourage the purchase of additional health insurance. The arguments for limiting the tax free nature of employment related health insurance are even stronger for health benefits than they are for other fringe benefits. Subsidizing the purchase of pension benefits and life insurance is not thought to exascerbate the spending in these areas whereas increased health insurance is regarded as a major cause of increased spending in the health area. Despite this fact, the tax cap has proven to be politically unattractive and has been roundly attacked by business, labor, and the insurance industry. An alternative to limiting health insurance expenditures, per se, would be to place a limit on the amount of fringe benefits which employees can take tax free. Having employees think of their fringe benefits as a pool of benefits which can be taken tax free up to a specified limit would encourage employees to be more aware of competing uses for the tax free funds. Since expenditures on employment related health insurance are currently tax free, an overall limit could only reduce the funds currently going into employment related health insurance.

APPENDIX A.—EMPLOYER INSURANCE CONTRIBUTIONS FOR FAMILY AND INDIVIDUAL GROUP INSURANCE COVERAGE, BY FAMILY INCOME, 1983

[Amounts in percent]

Family income (dollars)	Total subscribers (thousands)	Employer insurance contributions						
		$0	$1–$399	$400–$799	$800–$1,199	$1,200–$1,799	$1,800–$2,399	$2,400 or more
Family coverage:								
$1 to $9,999	1,672	12.4	8.7	20.0	9.3	24.2	13.4	12.1
$10,000 to $14,999	2,743	9.1	11.6	18.3	15.7	26.7	12.1	6.5
$15,000 to $19,999	4,650	11.6	8.2	16.7	10.1	26.5	18.3	8.7
$20,000 to $29,999	11,802	9.5	6.8	15.3	13.1	28.6	15.9	10.9
$30,000 to $49,999	16,708	7.9	5.5	11.3	12.3	26.7	20.2	16.3
$50,000 or more	7,246	8.5	7.8	9.9	10.9	28.6	21.4	13.0
Total [1]	44,854	9.1	7.0	13.4	12.1	27.4	18.3	12.8
Individual coverage:								
$1 to $9,999	2,591	27.5	22.5	32.9	11.7	3.0	2.1	0.5
$10,000 to $14,999	2,922	20.0	19.1	39.3	13.9	4.2	1.8	1.6
$15,000 to $19,999	2,849	12.1	14.1	47.2	16.6	6.2	2.4	1.4
$20,000 to $29,999	5,242	11.9	22.5	39.5	17.4	6.7	1.5	0.6
$30,000 to $49,999	6,368	12.2	16.8	42.5	16.8	8.0	2.2	1.6
$50,000 or more	3,734	15.9	17.9	39.7	15.3	6.2	2.5	2.6
Total [1]	23,773	15.3	18.8	40.5	15.7	6.2	2.1	1.4

[1] Includes persons with income less than $1.

Source: National Center for Health Services Research, National Medical Care Expenditure Survey, unpublished data.

APPENDIX B.—NUMBER OF SUBSCRIBERS AFFECTED AND TOTAL INCREASE IN TOTAL TAX LIABILITY FOR SPECIFIC LIMITATIONS ON TAX-FREE EMPLOYER CONTRIBUTIONS, 1983

[Amounts in millions]

Tax status of insurance premiums	Number of subscribers affected (thousands)	Total revenues increases			
		Federal income taxes	FICA [1]	State income taxes	All taxes [1]
I. No exemptions	61,575	$20,443	$6,465	$3,818	$30,726
II. $1,125 for family, $450 for individual policies exemption	44,431	7,998	2,488	1,511	11,996
III. $1,800 for family, $720 for individual policies exemption	23,497	3,454	1,057	658	5,169
IV. $2,400 for family, $975 for individual policies exemption	10,786	1,564	464	302	2,330

[1] Includes employers' share of FICA.

Source: National Center for Health Services Research, National Medical Care Expenditure Survey, unpublished data.

ENDNOTES

1. Emil Sunley. "Tax Policy Options" in Budget and Policy Choices 1983: Tax Defense Entitlements, Washington, D.C., Center for National Policy, 1983.
2. Gail Wilensky and Amy Taylor, "Tax Expenditures and Health Insurance: Employer Paid Premiums", Public Health Reports, Sept./Oct. 1982, Vol. 97, No. 5, and Amy Taylor and Gail Wilensky, "The Effect of Tax Policy on Expenditures for Private Health Insurance," in Market Reforms in Health Care, Jack Meyer, editor, Washington, D.C., American Enterprise Institute, 1983.
3. Amy Taylor and Walter Lawson, "Employer and Employee Expenditures for Private Health Insurance," National Center for Health Services Research, DHHS Publication No. (PHS) 81-3297, 1981.
4. Wilensky and Taylor, Taylor and Wilensky, op. cit.

Mr. HEFTEL. In your absence, Mr. Chairman, all of the panelists eloquently expressed the reasons why there is inequity, a loss of revenue and the need for remedy in the uncontrolled use of tax-exempt fringe benefits. I would have no questions except to compliment the panel, and to indicate that if we wanted that kind of testimony to support legislative action, this panel has certainly provided us with it. Thank you very much.

Chairman PICKLE. I am pleased to hear that. I apologize to the panel that I wasn't able to hear all the testimony. We had a press conference in the Senate announcing unanimous agreement on the disability reform bill. I certainly wanted to be there for that. Therefore, I missed some of your testimony. Let me, though, impose on you just a second. We have other panelists. We are going through lunch period so we can complete all of the panelists' testimony.

I want to observe, Ms. Munnell, that I am pleased to receive your testimony, and I have read part of it. I have enjoyed reading some of the commentaries and articles that you have written in various publications. I and our staff are impressed with them, so we are glad to have you here personally.

Ms. MUNNELL. Thank you.

Chairman PICKLE. Let me ask you two or three questions because they pertain to the approach we are trying to take. Earlier this morning a representative of the U.S. Chamber of Commerce challenged the assumption used by the Social Security trustees in their 1984 annual report, in projecting a straight-line decline in total compensation subject to FICA.

They seemed to indicate that the Social Security trustees have said there would be a straight-line decline on it. The chamber of commerce was saying they didn't believe that would happen. Do you agree with the trustees' report that there will be a decline in the wage base as a result of continued growth in employees' benefits? That is the first question. Do you agree with the trustees' report or with the chamber of commerce report?

Ms. MUNNELL. Before I answer, can I just congratulate you on the disability legislation compromise. I am delighted. That is wonderful.

Chairman PICKLE. Thank you.

Ms. MUNNELL. In terms of the Social Security trustees' projections, they project that fringe benefits will increase by 0.3 of 1 percent each year into the future, and that is incorporated into the long-run cost estimate. At first I thought that might have been too high, but after looking closely at the growth in fringe benefits, I think that is a reasonable projection. In the traditional benefits, I think pressure will develop in the pension area for some kinds of cost-of-living adjustment, and there are going to be increases in the health care area. In addition we have this new array of benefits that have been introduced. I think that Social Security actuaries are probably correct.

Chairman PICKLE. I will read your testimony. I want to make reference to one other part of your testimony for just a minute. Have cafeteria plans affected the growth and the distribution of employee benefits, and if they have, in what way have they?

Ms. MUNNELL. I am not sure that they have caught on quite as rapidly as I would have expected. I think that Congress's move of taking the taxable benefits out of cafeteria plans was excellent and desirable. I think the area where you have just seen astounding growth is 401(k) plans, which don't harm the payroll tax base but certainly erodes the income tax base.

Chairman PICKLE. Do you agree or how do you respond to the argument that including fringe benefits in the payroll tax discriminates against lower paid workers, anywhere below the $37,800 level?

Ms. MUNNELL. If you don't put them in the tax base, you are going to have to raise the payroll tax, and that is much more regressive than taxing fringe benefits.

Chairman PICKLE. One more question. I notice in your statement on page 8 you said that "We have made some curtailment" on fringe benefits, but most of it has been in closing loopholes of a tax avoidance nature. You said:

> I think the time has come for a more comprehensive approach to tax reform, that the reforms should be consistent with the nation's tax policies rather than an ad hoc response to losing federal dollars.

I presume you go on to make some outline. Would you want to comment further on what you would do?

Ms. MUNNELL. I would do two things. I would include all fringe benefits including pensions in the payroll tax base.

Chairman PICKLE. Under what?

Ms. MUNNELL. In the payroll tax base immediately. And in the case of the income tax, my proposal is more moderate, and that is to put a progressive cap on the amount of compensation that individuals can receive either tax-free or on a tax-deferred basis.

Chairman PICKLE. Is that recommendation in your testimony?

Ms. MUNNELL. Yes, sir.

Chairman PICKLE. Very interesting. I am glad to have your comment.

Do any of the other witnesses want to make further comments based on the testimony you have heard, or add anything to the testimony we have had?

Mr. SIMONSON. With respect to the first panel you heard from this morning, I would say the message was largely that the system works and you don't need to do much about it, that it is ridiculous to think that benefits are going to expand indefinitely at the same rate as you have seen in the past, and I would say that first of all there is a strong incentive for workers to seek more benefits.

I don't know if they will increase at the same rate, but when you look at combined income and employer-employee payroll tax of 35 to 40 percent that workers are able to avoid by taking tax-free fringe benefits, they will certainly want to see further expansion of fringe benefits. Congress did well to put a fence around some benefits this year, but you saw the enormous difficulty and the complexity in some cases of doing that. I think those struggles will continue, unless you work toward putting all fringe benefits in the tax base.

Chairman PICKLE. You may be right. That is a nice way to agree with you.

We thank all of you for your testimony. You have been very helpful to us. We appreciate your presence.

The next panel will consist of Susan Koralik; Carson E. Beadle, accompanied by Lloyd Kaye; and Manuel Castells.

Chairman STARK. I want to welcome the witnesses to the hearing, and thank you for coming. All of you have extensive prepared statements which, as you know, will appear in the record in their entirety. You can read your statements or you can summarize your statements. It will be your choice, because you have been invited, and some of you may feel, for certain reasons, that you would like to read the entire statement into the record. It is certainly your privilege to do so.

Having said that, I will just call on you in the order you appear on our witness list, which would put Susan Koralik of Hewitt Associates as the first witness. Proceed.

STATEMENT OF SUSAN KORALIK, PARTNER, HEWITT ASSOCIATES

Ms. KORALIK. I would be happy to try and summarize my statement. I would also like to take a minute afterwards, if I could, to respond to some of the issues that others have raised this morning.

Chairman STARK. That would be swell with me.

Ms. KORALIK. Much of the discussion that we have been hearing yesterday and today suggests that the benefits are offered for tax reasons, or alternatively, to allow the employer to push employees into retirement. Everybody seems to be ignoring the fact that benefits play a role in our society for the employees.

I would like to start by summarizing the major roles that benefits are playing. First, they do provide a mechanism for setting aside assets to provide a source of income for the elderly.

Second, they protect against the financial hazards of unexpected expenses due to health problems, disability or death.

Finally, benefits can be used to meet certain social objectives such as allowing women to more readily return to the work force.

But again, listening to the recent discussions, we seem to be just calling these loopholes now, and we are looking at employer-sponsored health plans as a $21 billion drain on the revenues.

But with hospital costs rising at 12.5 percent per year, we should be looking at these plans as a system that allows access to quality medical care without a need for socialized medicine, national health insurance or the expansion of medicare and medicaid.

We should look at the employer-sponsored plans as a way of providing adequate income for the elderly. A number of people have already commented on how well we have done in terms of expanding the coverage to the majority of the work force, and one of the issues that has been raised is,"But we still have this inequity."

I agree that there is an inequity there, but perhaps we should solve the inequity, not by taking away from those who have the coverage, but by finding a way to give coverage to the have-nots. So let's applaud ourselves for providing coverage for 80 percent of the workers, and try to find some solution for the other 20 percent.

One question that has been raised is to what extent do the tax incentives affect the employer's decision to offer benefits? The answer is very little.

The reason for that is that you are really focusing on the wrong question. The employer will get the tax deduction if he pays the employee in cash or if he pays the employee with benefits.

The question to consider is to what degree does the tax status affect the employee's decision to demand a benefit or to even accept a benefit as part of the compensation package. And there, we think the tax status has a great influence.

We believe that if benefits were not nontaxable or tax deferred employees would likely demand a cash option for each benefit.

Let's just consider the two major benefit areas, retirement and medical. If employer contributions to retirement benefits were currently taxable, the employee would have no incentive to allow the employer to have control over the assets.

The employee would say, "Give me the money. I will pay my taxes and I will save the rest." So what we would see would be a tremendous drop in the participation in employer plans, if there was a choice, and eventually a drop in the provision of employer plans to the employees.

The employees would not be willing to pay increased taxes now for something that they might receive later. They would want cash instead of the employer contribution to retirement.

On the medical side, we would again predict a change in the employee behavior if the tax incentives were altered. Employees impute a value for their medical coverage based on their actual or expected personal usage of the plans.

Employees who repeatedly face large medical expenses assign a great value to the plan, but employees who tend to be healthy value the plan much lower. They see it as protection for rare occasions.

Many employers today are trying to make employees appreciate the value of the plan, but what they are communicating is the average value, or the value after pooling the high and low risks. They communicate the premium that they pay to the insurance company.

Employees accept this pooling as long as it doesn't appear to cost them anything. But when employers require that employees contribute something to be covered under the plan, we do see a change in behavior.

The studies indicate that as employee contributions go up, the number of employees dropping coverage increases. Companies with flexible benefit programs, where they have had them in place for a few years, have seen a pattern in which the lowest risk employees choose the least costly plans.

And the highest risk employees stay in the most expensive plan. So, as the price of the richest plans go up, the number of employees opting down increases.

Taxing employees benefits on part or all of the value of the medical values would produce the same behavior patterns. If we used a pool, the average value, which all of the proposals have suggested, what we would have is the best risks would begin to demand cash equal to the average value of the medical plan.

Some of the people have suggested we take the entire $2,000 cost of a medical plan and make that taxable income to the employee. The employee who never files a claim would come in and say, "Thank you very much, but I will just take the $2,000 and then I will pay my taxes. I don't want just an extra $500 in taxes to be paid."

One further complication would be that the taxable value would be a greater percentage of pay for the lower paid than for the higher paid employee, so what we would probably see are more changes in behavior, dropping coverage, among the people least likely to accept the risk.

If the taxes were imposed only on the average value in excess of a stated amount, some sort of cap, employers could respond by offering a lower value plan.

However, this would not be popular with the employees who want the better protection, so the ideal solution would be the flexible approach, in which the low risk employees could choose lower priced plans without opting out of coverage altogether.

But at this point, it should be noted that only about 200 employers are offering flexible programs, and there seems to be a lot of concern as to whether flexible programs are good or not.

It looks like it might be the only solution, if you are talking about a cap, so let's at least not kill the only solution that we have.

Just to summarize, we see the major factors being: First, the need for financial protection is still there, second, the employer is in the best position to provide that financial protection, third, the employer's decision on how he structures the program is largely a response to the employee's demands, and fourth, the employee's demands, or behavior, are likely to change if some or all of the value of the benefits become taxable.

The nature of the change will likely result in lower paid persons opting for less or no coverage.

We would conclude that taxing employee benefits should not be seen as just an issue of raising revenue. It will change behavior. Taxing employee benefits would reduce the level of protection that we have in this country today.

[The prepared statement follows:]

STATEMENT OF SUSAN KORALIK, PARTNER, HEWITT ASSOCIATES

Hewitt Associates is a consulting firm specializing in employee benefits and compensation. Since the company was founded in 1940 we have worked with over 3,500 employers and our research staff has routinely collected and analyzed benefit data to identify common practice and trends. We would like to comment on the appropriations of providing tax-favored status for employee benefits in 1984 and the future.

Employee benefits play an important role in our society.

(1) They provide a mechanism for setting aside assets to provide a source of income for the elderly. Retirement plans can prevent dependency on welfare systems, and provide a supplement to Social Security to permit a more realistic replacement of preretirement living standards.

(2) Benefits protect against the financial hazards of unexpected expenses due to health problems, disabilities and death. By encouraging the pooling of these risks, individuals can be protected without depending on welfare.

(3) Benefits can be used to meet certain social objectives such as allowing women to more readily return to the workforce.

Listening to recent discussions about employee benefits, it appears that some have lost sight of these objectives. The discussions now suggest that benefits are tax loopholes. There are those who look at the cost of employer sponsored health plans as a $21.3 billion drain on revenues. With hospital costs rising at 12.5% per year, we should look at these plans as a system that allows access to quality medical care without a need for socialized medicine, national health insurance or the expansion of Medicare and Medicaid. Similarly, we should look at employer sponsored retirement plans as a means of providing adequate income for the elderly without putting further demands on Social Security.

As we consider employer sponsored programs here in the United States, we can be proud of our accomplishments. Over 70 million workers are covered under qualified retirement plans and over 100 million are covered under medical programs. These are not programs that help only the highly paid. We have achieved broad-based participation covering most employed workers at a cost in government revenues that is less than if this protection were delivered through federally sponsored plans. Therefore, we see a need to continue to provide protection through employer sponsored plans.

However, a question has been raised regarding the continuing need for tax incentives. Since employee benefits are now an expected part of total compensation packages, would employers maintain the programs if the tax incentives were removed? In other words, to what extent do tax incentives influence an employer's decision to offer various employee benefits? We believe the answer is, "very little."

The employer has no tax incentive to offer or not offer a benefit. The employer will get a tax deduction whether compensation is paid in cash or in benefits.

So, what influences the employer's design of a total compensation package?

(1) Employers try to create an atmosphere of security. They want the company to be seen as a good place to work. And if employees aren't concerned with their financial security, they can focus on higher productivity.

(2) Management may want to provide retirement benefits to ease people out of the workforce in a graceful manner and to open up jobs for younger employees.

(3) The most influential factor is probably employee demand. To attract and retain the best workers, an employer must offer a competitive total compensation program. It must be generally competitive in total dollar value. But it must also be structured to suit the preferences of the employees.

It's at this point that the tax incentives begin to have influence. The question to consider is to what degree does the tax status of benefits influence the employee's decision to demand or even accept a benefit as part of the compensation package. We think it has a great influence.

If benefits were not nontaxable or tax deferred, employees would likely demand a cash option for each benefit. Consider the two major benefit areas—retirement and medical.

If employer contributions to retirement plans were currently taxable, the employee would have no incentive to allow the employer to have control over the assets. The employee would say, "Give me the money so I can pay my taxes, and I'll save the rest." We would see a tremendous drop in employer sponsored retirement plans. Employees would not be willing to pay increased taxes now for something they might receive later.

Would employees save after-tax dollars independently? If they would, we could meet our social goals without deferring the tax revenues. But we don't think this is a realistic goal. Research indicates that for a significant portion of the population, employer sponsored plans represent their only real savings. Even with tax incentives, individuals don't save independently for retirement. Less than 17 percent of the workforce has established an IRA. And among those who have IRAs, over 50 percent reported that the source of funds was accumulated savings rather than current income. Money is just being shifted from one account to another, with little increase in real savings. Therefore, if having income to supplement Social Security for the elderly is an important social objective, we need the tax incentive to maintain employer sponsored plans, otherwise the impact is less retirement security.

As we look at medical benefits, we again would predict a change in employee behavior if the tax incentives were altered. Employees impute a value for their medical coverage, based on their actual or expected personal usage of the plan. Employees who repeatedly face large medical expenses assign a great value to the plan. But employees who tend to be healthy value the plan much lower, as protection for rare occasions. Many employers today are trying to make employers appreciate the value of these plans. But what they communicate is the average value—or the premium after pooling the high and low risks. Employees accept this pooling as long as the plan doesn't appear to cost them anything. But when employers require that an employer contribute some amount to be covered under the plan, we see a change in behavior. Studies indicate that as employee contributions increase, the number of employees dropping coverage increases. Companies with flexible benefit programs in place for a few years have seen a pattern in which the lowest risk employees choose the least costly plans. And as the price of the richest plans go up, the number of employees opting down increases.

Taxing employees on part or all of the value of medical benefits would produce the same behavior patterns. If we used a pooled or average value, which all of the proposals have suggested, the better risks would begin to demand cash equal to the average value of the medical plan. Can you imagine the reaction of a healthy employee who is given an annual tax bill of $500 for medical coverage he hasn't used. One further complication would be that the taxable value would be a greater percentage of pay for the lower paid than for the higher paid employee. Therefore, we would probably see more changes in behavior—dropping coverage—among the people least able to accept the risk.

If taxes were imposed only on the average value in excess of a stated amount, employers could respond by offering a lower value plan. However, this would not be popular with employees who wanted the better protection. The ideal solution would be the flexible approach in which low risk employees could choose lower prices plans without opting out of all coverage. At this point, however, only about 200 employers are offering employers choices through flexible plans.

CONCLUSIONS

Looking at the available data and the trends we have also been able to identify over the years, we can draw some conclusions about the appropriateness and the impact of taxing employee benefits. First, here is a summary of the major factors:

(1) The need for financial protection for unexpected expenses and savings for retirement has not changed. And, the employer is in the best position to offer coverages the individual cannot get on his own, to pool the risks among employers, and to make prudent investments on plan assets. So, employer sponsored plans are a necessity.

(2) The employer's decision on how to structure the total compensation package is largely a response to employee demand.

(3) Employee demand or behavior is likely to change if some or all of the value of benefits becomes taxable. The nature of that change will likely result in lower paid persons opting for less or no coverage.

Therefore, we would conclude that taxing employee benefits is not just an issue of raising revenue. Taxing employee benefits would reduce the level of protection that we have in this country today.

Chairman **Stark**. How do you deal with the suggestions that you make the plan progressive, one suggestion which was 25 percent of the first $40,000, so the low paid employees are going to get all of theirs tax free? That would obviously answer that.

They would take it then, right?

Ms. **Koralik**. Yes, that wouldn't be a problem. If the low-paid employees did not face a tax, then they probably wouldn't change their behavior.

Chairman **Stark**. By definition, the high-paid employees are so intellectually alert that they would not follow emotion.

Ms. **Koralik**. Hopefully.

Chairman **Stark**. But sound economic choice.

Ms. **Koralik**. Yes.

Chairman **Stark**. Thank you.

Carson Beadle and Lloyd Kaye on here as a team. Do you each have separate testimony?

STATEMENTS OF CARSON E. BEADLE, MANAGING DIRECTOR, AND LLOYD S. KAYE, VICE PRESIDENT, WILLIAM M. MERCER-MEIDINGER, INC.

Mr. **Beadle**. No, we just have one testimony. Lloyd Kaye has also made himself available to answer questions.

Chairman **Stark**. Fine. Why don't you proceed, then?

Mr. **Beadle**. Mr. Chairman, you pose questions in your framework for these hearings that we think go right to the heart of the taxation and fringe benefits issues.

They are precisely the questions on which we wanted answers when we began our annual survey last spring, to which over 500 CE's have now responded. The survey results are attached to our written testimony, and I think should be quite helpful to your committee in its deliberations.

I thought I would take just a few minutes to summarize those findings that address your questions particularly, and then offer some observations based on our own experience.

I would like to emphasize from the outset that it has been our experience that the broadening of income security benefits that has evolved over the last 35 years has been significantly influenced by the special tax status afforded to these benefits, and as Susan has just said, any significant change in that status will reverse the trend.

Employee benefits have been different from fully taxable compensation, and though their tax favored treatment has not been the basic reason for the existence of benefit plans, it has played a significant role as distinguishing characteristic in encouraging their growth by making these benefits more affordable to employees.

You asked about the effect of tax favored treatment on the selection of fringe benefits. The CEO's that answered our survey were asked if Congress were to eliminate many of the tax preferences from employee benefits, how do you believe U.S. companies would generally react?

Sixty-six percent believe that companies would cut their benefits. We asked the question in different ways. For example, we asked if tax preferences had encouraged companies to sponsor employee plans, 69 percent said yes.

We asked if the current policies of providing the preferences should remain intact; 87 percent said yes.

We asked if eliminating some of the preferences would be a sensible approach to reducing the deficit; 81 percent said no; 72 percent of these went on to say that reducing benefits will put pressure on government to increase social security and provide additional welfare benefits.

When we asked them well, why company-sponsored benefit plans in the first place, the answer did not affect taxes. In fact, that ranged only for such reasons as remaining competitive for labor, concern for employees' economic security, and desire for good employee relations.

The essential conclusion that permeated the responses is that the tax favoring of benefits has played a very large role in encouraging employers and employees alike to provide for their own income security and health benefits.

Chairman **Stark**. Excuse me, let me go through that again. You say in the survey, the employers said it wasn't very important, the tax considerations.

Mr. **Beadle**. It is a very important point to distinguish here. It has not influenced the selection of specific benefits, but the fact that it has made benefits more attainable by employees through lower cost, tax favoring lower costs, has encouraged employees——

Chairman **Stark**. Employers?

Mr. **Beadle**. No, encouraged employees to be ready to have employer sponsored benefit plans, to in fact demand them, ask for them, or be sold on them, because there was an incentive.

Chairman **Stark**. But the employers are indifferent?

Mr. **Beadle**. As Susan has said, for the employer it doesn't make much difference whether it goes into cash or into benefits.

Chairman **Stark**. Right. The employer has an eleemosynary sort of thing, he wants to be a nice person.

Mr. **Beadle**. It must be a good place to work. I was going on to say that the tax preferences are not the reason benefit plans are implemented, but they are certainly a facilitator insofar as the employees are concerned.

You had a question about horizontal and vertical equity of the income tax system. Regarding vertical equity, our survey group felt that our employees would be affected most by the elimination of tax favored status of benefits.

The next group would be the administrative clerical, and then middle and top management. On the subject of horizontal equity, and this is a personal opinion, we have 150 million American employees and their families to attest to the fact that well-placed tax incentives entice people to acquire their own necessary protection, and those that have been denied these incentives tend not to take out adequate coverage to protect themselves, and I believe that is a group that the committee has been concerned about.

The question was also asked what shift might occur in the incidence of income tax if benefits were to become taxable. It is our opinion that little shift would occur between higher and lower paid employees, because the caps and the discrimination rules already in effect covers most employee benefit situations.

There would, though, be a wrenching shift in the form of taxation that would become payable by all taxpayers.

Since benefits were first introduced, they were understood by employees to be for the most part without taxation, or more correctly, according to our survey, 85 percent of the respondents believe employees don't even realize they have a tax advantage, but they do know what their current tax subsidized costs are, and any major shift of tax benefits would be seen to be a tax increase to every employee in the country.

In fact, the cost of benefits such as health insurance tend to be level regardless of income, so that they might well be considered a regressive form of taxation.

When you think about it, the benefits are very personal to employees, and any benefits reductions brought about in response to taxing them would likely be seen by taxpayers to have a greater dollar effect than the taxes actually assessed.

Susan addressed the question of whether employees would buy benefits indepedently even if they were tax-free. In our survey, 88 percent of the CEO's said they don't believe employees would buy pension benefits even if their salaries were increased to make up for reduced benefits; 84 percent think employees wouldn't replace reduced health benefits.

Your next question concerned caps. In our survey, we asked, would you favor——

Chairman **Stark**. Could I interrupt there? When you say the employees wouldn't want benefits, did you take into account those employees who are represented by bargaining units?

Mr. **Beadle**. We posed that question separately, and the unions expressed, at least the CEO's believe that the unions would press very hard to retain benefits. Of course, they would attempt to retain them without any reduction in cost so that would represent an increase in payroll costs, you might say.

Chairman **Stark**. Thank you.

Mr. **Beadle**. On the question of caps, the question we posed was would you favor or oppose proposals to place a cap on employer paid health insurance premiums. The majority of respondents believe that caps would cause internal inequities between employees, that is, between older and younger employees as well as geographic inequities and would not contain the rising costs of health care.

On the other hand, though, a significant number felt that a cap on health insurance premiums would lead to more cost-effective medical care, and would increase employees' awareness of the costs of benefits incurred by the employees, so we found a difference of opinion even by the CEO's on the question of caps.

But 70 percent of them believe that limiting the amount of tax-free employer contributions to pensions and profit-sharing plans would be unfair to lower-paid and long-term employees, because the relative cost is higher there.

Personally, I would be concerned that any cap that would treat with reasonable fairness and equality the wide demographic range in the work force, for example, from a young, two-parent manufacturing family in New York, to a near-retirement electronics worker in Spokane, in a system that could monitor its application, would add a complex layer of regulation in an already heavily legislated area, and all this would accomplish is to add virtually equal tax income at all income levels.

The point is that tax increases in this form would create serious inequities for employees. Since benefits are deferred income, and employees want to spend their money now, benefit expenditures will control themselves, except possibly for the higher paid, where pension and discrimination limitations already provide caps.

We wondered in our survey whether a change in the tax preferences would have any effect on U.S. capital markets and capital formation, given that there are currently about, I think, $900 billion in pension assets.

Eighty-seven percent of the CEO's said there would be an effect, with 41 percent believing the extent would be great.

On another point, discussion of employer-paid costs, has centered on there being an alternative form of compensation, and there are some good arguments for this.

However, the vast majority of benefits enhance the work environment, just as surely as safety equipment or workers' compensation. These benefits then might be considered not only in the simplistic sense of being a form of compensation, but also as a noncompensation cost of doing business that contributes to a more secure attractive work environment, and any shift away from the providing of benefits by employers can also have a lessening effect on employees' attitudes to the workplace, and employers' concern for their security.

I have also noticed that the vast majority of employees are not using today's spendable cash which they need for rent and food or want for cars and TV's, to buy unneeded benefits or to save for excessive pensions just because they are tax-free.

Some may want more or less protection, because as individuals they are more or less insecure, but they don't seem ready to waste their valuable spendable income.

You asked about the most efficient use of resources either by encouraging employers to provide benefits through tax treatments or by providing them directly through directly funded public programs.

We know from experience of other countries, Britain, Denmark, Canada, that governments can provide benefits directly. We also know that these countries have their own serious financial and political problems in controlling costs.

Foremost is the difficulty in cutting benefits under universal programs, even in areas where we find there is no need, and that is a problem we have already experienced under our relatively limited programs here in the United States.

Health care is a current example——

Chairman **Stark**. Which programs were those?

Mr. **Beadle**. I think in the case of Social Security, we have wondered whether everybody needs the universal benefit. You certainly can't afford to take it away from anyone because it is a universal program.

It is very difficult for government to be selective about who should receive a benefit it is sponsoring.

Chairman **Stark**. Once it is started.

Mr. **Beadle**. Right, precisely. Health care costs are a good example. What we are seeing in the private sector right now is a scramble to bring health care costs under control, and to increasingly involve employees as individuals in the decisionmaking on how that money is spent.

The entire community, employers, union, employees, hospitals, doctors and others, like consultants, like us, are all addressing the issue of rising health care costs, each from its own perspective, each searching for the right answer in its own area, and unencumbered by any overall singular scheme that has had to be imposed on a nationwide or industry-wide basis.

That approach does produce some turmoil and pain during the search for the right answers, but I believe that is still the system that will produce the most cost-effective solutions once it has run its course.

I do fear though that the rule assumed by the private sector may be more fragile than is commonly believed. In the equation we are now studying, we need to consider with care that any reversal in this tax favored treatment runs the danger of reversing the trend of employer support, and possibly even abdication of the role, and that is particularly true in respect to smaller employers who already find the costs difficult to absorb.

I agree there is a limit to the amount of tax-favored treatment we can afford to give to non-cash compensation, but we have all seen that when it is used judiciously as an incentive to achieve social objectives, it has been extremely effective.

I believe then that the benefits to which we accord tax-favored treatment should be only those which support the country's social policy, and limits should be applied only where abuse is a significant factor.

I think, Mr. Chairman, it is a tribute to the system that committees such as yours are examining this important subject with such care and we at Mercer-Meidinger are dedicated to assisting you in any way we can.

Thank you.

Chairman PICKLE. Thank you very much.

[The prepared statement follows:]

STATEMENT OF CARSON E. BEADLE, MANAGING DIRECTOR, WILLIAM M. MERCER-MEIDINGER, INC.

Mr. Chairman and distinguished members of the Subcommittee, I am Carson E. Beadle, Managing Director of William M. Mercer-Meidinger, Incorporated, a benefits and compensation consulting firm operating in forty cities in the United States as well as in major cities around the world. In my thirty years in the employee benefits field, I have worked with employers, joint union-management trusts, medical societies and governments.

The questions you have posed in your "framework" for these hearings go to the heart of the issues of "the distribution and economics of employer provided fringe benefits".

Our firm has been concerned over the years about what should properly drive the design of employee benefits. We have examined with our clients why an employer should provide benefits, how they should be provided, and what are the final implications. With the specific issue of tax preferences in mind, we began a survey last spring. We released that survey here yesterday, and it is included in this testimony.

Last week many of us had the privilege of hearing Senator Javits' comments to the Subcommittee on Aging, of the U.S. Senate. He voiced his pride in the growth of private sector pension plans and the vital needs these meet for those on or approaching retirement. He also spoke about the very favorable ratio of benefits these plans provide vs. the tax revenue forfeited, and on the importance of social policy when talking about cutting costs or raising taxes.

It has been our experience also that the broadening of income security benefits that has evolved over the last thirty-five years has been significantly influenced by the special status afforded to these benefits by their special tax treatment. Employee benefits have been different from fully taxable cash compensation and though their tax-favored treatment has not been the reason for their existence, it has played a significant role as a distinguishing characteristic and has encouraged their growth by making these benefits more affordable to employees.

In your announcement of these hearings, you asked first about the effect of tax-favored treatment on the selection of fringe benefits.

The C.E.O.'s that answered our survey told us that virtually all the issues that have influenced the design and implementation of most plans are non-tax issues. They added that tax status has little direct effect on benefit selection even though it has significant impact on their readiness to implement benefits generally.

36 percent of our respondents said that employers sponsor benefit plans in order to be competitive.

26 percent expressed concern for the economic security of their employees.

25 percent identified desire for good employee relations as their reason.

5.2 percent cited tax effectiveness compared to direct compensation.

We found somewhat the same answers from another Mercer-Meidinger survey released last week, which focused only on flexible benefits. We asked what plan sponsors had hoped to achieve in undertaking the considerable effort and expense in implementing these flex plans.

31 percent of the respondents said they implemented their plans to "encourage cost containment."

25 percent have "flex" plans "to give employees greater choice."

23 percent have "flex" plans to "foster employee relations."

Your next question asked about the effect of tax-favored treatment of benefits on the horizontal and vertical equity of the income tax system. Our survey group felt that hourly employees would be affected most by the elimination of the tax-favored status of benefits, followed by Administrative/Clerical employees, and then by Middle and Top Management.

You asked what shift might occur in the incidence of income tax if nontaxable benefits were to become taxable. It is our opinion that little shift will occur between higher and lower paid employees. Nontaxable group life insurance is currently pegged at $50,000 which would generally apply to those earning $25,000 or less. Health insurance costs apply roughly equally at various income levels; disability insurance usually has a maximum eligible salary which is a limit imposed by underwriters. And pensions, and 401(k) plans have a combination of dollar limits and discrimination tests which for the most part prevent nontaxable contributions from producting benefits which are inconsistent with the relative income needs of all levels of wage earners.

There would however be a wrenching shift in the form of taxation that would become payable by all taxpayers. Since benefits were first introduced, they have been understood by employees to be for the most part without taxation. A major shift to tax benefits would be seen as a tax increase to every employee in the country. In fact, the costs of benefits such as health insurance tend to be level regardless of income so that taxing contributors would be a regressive form of taxation.

Benefits are very personal to employees and any benefit changes brought about in response to taxing them would likely be seen to have a greater dollar effect than the taxes actually assessed.

Your next question concerned caps. In our survey we asked a question much like yours. We asked: "Would you favor or oppose proposals to place a cap on employer-paid health insurance premiums? (All amounts over the limit would be taxable income to the employees.)"

Fifty-six percent of the respondents voiced opposition citing such reasons as: a cap would cause internal inequities between employees (e.g. between older and younger employees) as well as geographic inequities; a cap would not contain the rising cost of health care; and government should not interfere with business.

Thirty-nine percent favored the use of a cap because in their view: a cap would force the medical industry to provide cost-effective medical care and would decrease the cost of health care; caps would increase employees' awareness of the costs of benefits incurred by the employees (an argument also made in support of flexible benefit plans).

In another open-ended question, 70 percent of the respondents expressed opposition to the idea of limiting the amount of tax-free employer contributions to benefits such as pensions and profit sharing plans, saying that such a cap would be unfair to lower-paid and long-term employees.

We asked which type of cap they believe would be most fair. Those who responded ranked caps as follows: 43 percent cited a flat-dollar cap indexed to inflation; 29 percent named a flat-dollar cap in the same amount for all employees; and 14 percent each identified a cap based on employee geographic location and a cap based on age.

You asked about the relationship between private sector benefits and social programs and the effect on federally funded social programs if employers did not provide fringe benefits.

Again, that question was asked specifically in the Mercer-Meidinger C.E.O. survey. We first asked whether they agreed or disagreed that "if many tax preferences for employee benfits are eliminated, the majority of U.S. employers will reduce their employee benefit programs. 79 percent believe this will happen.

To find out more specifically which benefits would be most affected, we asked the respondents how they expected each of 15 different benefits to be affected by tax change. That is, would each of these benefits be increased or decreased between now and 1990 if tax preferences remain unchanged or if they are reduced or eliminated. The answers, which I think you will find interesting, are on page 19 of our survey.

We then asked that if they thought benefits would be reduced, did they believe this "will put pressure on the government to increase Social Security and/or provide additional welfare benefits". 72 percent answered "yes" and 21 percent answered "no".

Let me now share with you some views that I have based on my years as an interested observer.

Discussion of benefit costs has tended to center on employer paid benefit costs as an alternative form of compensation, and there are some good arguments for this. In reality though, the vast majority of benefits enhance the work environment just as surely, for example, as safety equipment and workers compensation, by providing a vehicle for employers and employees alike to prepare in advance for those contingencies that could otherwise be destructive to them.

These benefits then might be considered not only in the simplistic sense of being a form of compensation but also as a non-compensation cost of doing business that contributes to a more secure, attractive work environment. Any shift away from the providing of benefits by employers will also have an effect on employees' attitudes to the workplace and employers' concern for their employees' security.

I have also noticed that the vast majority of employers and employees alike do not appear to be using today's spendable cash which they need for rent and food or want for cars and TV's, to buy unneeded benefits or to save for excessive pensions because the costs are tax free.

Regarding caps, I would be concerned that caps that would treat with reasonable fairness and equality the wide demographic range in the workforce, from a young two-parent family in New York to a near-retirement worker in Spokane, in a system that could monitor its application, would add another complex layer of regulation in an already heavily legislated area.

You asked about the most efficient use of resources, either by encouraging employers to provide benefits through preferred tax treatment or providing them through directly funded public programs.

To me this is at the very heart of the matter of tax-favored benefits.

We know that publicly funded programs are taking a growing proportion of the GNP.

We know that controlling the costs of publicly funded programs on a broad scale has been difficult even though there have been some notable efforts such as Medicare's DRG program.

And we know how difficult it is to cut benefits under universal programs even in areas where we find there is no need.

Health care is a current example of the need to contain costs. We have are seeing in the private sector is a scramble to bring health care costs under control and to increasingly involve employees as individuals, in the decision making on how much money is spent. Flexible medical plans, for example, let employees decide whether they want to pay a much higher contribution for a low deductible. 401(k) plans let each employee decide whether they want to save relatively a lot or a little for their retirement.

And, the entire community—employers, unions, employees, hospitals, doctors and others such as consultants like us—are all addressing the issue of rising health care costs, each from their own perspective, each searching for the right answer in their own area, unencumbered by any overall scheme that has had to be imposed on a nation-wide, industry-wide basis. I believe that although this approach produces some turmoil and pain during the search for right answers, the system will produce the most cost effective solutions.

I believe also that the floor of protection provided by public programs such as Social Security, Medicare and Medicaid are important to be preserved and to be linked cooperatively with private sector plans which have done an outstanding job of providing income security and health care benefits to about 150 million employees and their families with little government effort beyond creating a favorable, supportive tax climate.

I do fear, however, that the role assumed by the private sector may be more fragile than is commonly believed. In the equation we are now studying, we need to consider with care that any reversal in this tax-favored treatment beyond fine-tuning to remove abuses, runs the danger of reversing the trend of employer support and possibly even abdication of the role. This is particularly true in respect of smaller employers who already find the costs difficult to absorb.

I agree there is a limit to the amount of tax-favored treatment we can afford to give to non-cash compensation, but we have all seen that when it is used judiciously as an incentive to achieve social objectives, it has been extremely effective. I believe then that the benefits to which we accord tax-favored treatment should be those which support the country's social policy and limits should be applied only where abuse is a significant concern.

It is a tribute to the system that committees such as this are examining this important subject with such care and we at Mercer-Meidinger are dedicated to assisting in any way we can.

Employer Attitudes Toward Employee Benefits and Tax Change

A Mercer-Meidinger Survey, September 1984

WILLIAM M.
MERCER - Meidinger
INCORPORATED

William M. Mercer-Meidinger, Incorporated

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Preface

The substantial federal deficit has prompted several members of Congress to look skeptically at the tax-favored status of employee benefits as though they represent a tax give away that bears no relation to the social objectives of the nation.

Some view this special status for income security and medical benefits as a "revenue loss" which should be stopped by cutting back or eliminating the traditional benefit program tax preferences which have been granted to both employers and employees.

This issue is attracting increased attention from our legislators. If legislators focus on "revenue loss" rather than on the "income security needs" of virtually all U.S. employees and their families, their actions could have a material and possibly unintentional effect on the manner in which financial security is provided to 150 million Americans.

In hopes of contributing to this discussion, William M. Mercer-Meidinger, Incorporated, the employee benefit and compensation consulting firm, has conducted its eighth annual survey of chief executive officers to elicit their views on the tax status of employee benefits.

The 502 CEOs who responded to the survey represent America's large and medium-sized corporations in a variety of industries. Forty-six percent of the respondents head companies employing over 5,000 employees, with 14 percent employing more than 20,000 employees.

Their overwhelming conclusion is that any material change in tax preferences for employee benefits will significantly alter the role of employers and employees in providing for their own income security and will create pressure on the government to fill any void left by reduced company-sponsored benefit programs.

Survey Highlights

Introduction

Questions frequently asked are whether tax preferences have influenced the private sector's initiatives to provide income security and medical benefits to employees and whether this initiative and the level of security employees currently enjoy would be reduced if tax preferences were removed.

The survey results indicate that tax preferences have set benefits apart from cash compensation and in so doing have encouraged employers, unions and employees to provide for themselves a higher level of income security than might otherwise have been possible. This in turn appears to have minimized pressure on the government to provide such benefits.

According to the survey findings, changing the tax laws without considering the effect on present employee benefit programs may lead to a reduction in the benefits that employees and employers currently provide for themselves.

1. Employee Benefits, Tax Preferences and the Federal Deficit

The chief executive officers surveyed were virtually unanimous in believing that the federal deficit must be reduced. Two-thirds said efforts to reduce the deficit are "crucial" and one-third said they are "important."

They do not believe, however, that changing the tax status of benefits is an appropriate method for reducing the deficit, nor that any revenue loss attributed to tax-sheltered plans that help employees prepare for their retirement is too great.

Most believe that the current policy of providing favorable tax treatment for employee benefits should remain essentially unchanged and foresee several problems that would result from changing tax policy. Eighty to ninety percent believe there would be a negative effect on the health and welfare of workers and their families and on the economic security of retired workers, because the majority of U.S. employers would, according to survey results, cut back on their benefit programs.

This, they believe, would put pressure on the government to increase Social Security or to provide additional welfare benefits. Significantly, CEOs are of the view that such company-sponsored benefit reductions would have a negative effect on U.S. capital markets and capital formation.

2. The Effect of Tax Change on Employees and the Structure of Benefit Plans

The CEOs were more pessimistic about what would happen to employee benefits at U.S. companies in general than at their own companies. This may be true because those companies represented in the survey are among the largest U.S. corporations which might be expected to maintain more generous employee benefit programs.

When asked how companies would react if many of the present tax preferences were eliminated, 41 percent thought companies in general would cut back their benefits, while only 28 percent thought their own company would do so.

Only 30 percent of the CEOs thought all U.S. companies would maintain their benefit programs at current levels if tax preferences were eliminated, while 47 percent thought their own company would maintain its benefits. The rest predicted that benefits would be cut, and direct compensation increased, so that the total would remain constant.

When asked to consider what would occur if benefits were reduced but compensation increased, 88 percent believe that employees would not invest the extra money to ensure their future financial security and 74 percent believe employees would not buy replacement insurance to make up for lost benefits.

Hourly workers would, in the view of the CEOs, be affected most by any change in the tax status of benefits. Almost half predict that union leaders would ask employers to maintain current benefits, and less than 1 percent thought union leaders would accept the reduction in total compensation that would occur if benefits became taxable to employees.

3. Views Are Split on Capping Employer Contributions

Placing additional caps on tax-free employer contributions to employee benefit plans has been the subject of frequent discussion and several proposals to Congress. When CEOs were asked what they thought about these caps, 56 percent said they opposed them because they would cause internal and geographic inequities among employees. Thirty-nine percent favored caps as a means of increasing employee awareness of the costs of benefits incurred by the employer.

Those favoring caps felt they would force the medical industry to provide cost effective medical care, while those opposing caps believed that caps would not contain the rising cost of health care.

When asked how their company would react if a dollar cap was enacted which was lower than their current medical plan premiums, 44 percent said they would probably establish a second, more limited medical plan with premiums below the cap and offer employees a choice between two plans. A third of the respondents would make no changes, while the remainder would cut benefits to a level where costs would fall beneath the cap.

When the concept of capping contributions is extended beyond medical plans to pensions and other benefits, opposition rises to 70 percent. Respondents believe such caps "would be unfair to lower-paid and long-term employees" and that "employees need an incentive to save for retirement." If a cap were to be placed on benefits, the CEOs thought it would be fairest to have a uniform dollar cap, indexed to inflation.

4. Effect on Capital Markets

The assets of private tax-qualified pension plans now exceed $900 billion. A change to limit the tax status of these funds would, in the opinion of 87 percent of the CEOs, affect U.S. capital markets and capital formation. Forty-one percent of the CEOs said they believe capital markets would be affected "to a great extent."

5. Reduction of Benefits Will Press Social Security System

CEOs, who said they thought employers would reduce their benefits if tax preferences were eliminated, were asked if they would expect increased pressure on the government to increase Social Security and/or to provide additional welfare benefits. Seventy-two percent believed this would occur.

Most of the respondents—86 percent—strongly support tax-sheltered savings plans such as I.R.A.s, 401(k)s and thrift plans because they believe employees need to be encouraged to save for retirement because "employers and Social Security cannot do it all."

6. Tax Preferences And The Future Of Benefits—A Message To Congress

The survey findings identify several issues that warrant thoughtful consideration in any examination of proposals to reduce or eliminate tax preferences for employee benefit plans.

Income security and medical benefits provided by employers are very much an integral part of the U.S. socio-economic system. Of the companies in the survey, 99 percent provide medical insurance, 98 percent provide group life insurance, 95 percent have retirement plans and 87 percent have disability insurance plans.

According to the CEOs, these programs are provided for three main reasons. First, to remain competitive in the labor marketplace and attract to good employees. Next, to encourage good employee relations, and third, because of their concern for the economic security of their employees.

If favorable tax treatment of these programs were reduced, company-sponsored benefit programs would not disappear, but—according to the CEOs—benefits would probably be cut back. Employees would suffer, with the lower-paid employees being affected most. Employees would not likely replace reduced benefits on their own. Pressure would be placed upon the government to make up some of the difference.

As for future benefits, a continuation of existing tax preferences would not prompt employers to increase most benefits beyond their present level, but would lead to more flexible benefit plans, 401(k) plans and child care benefits.

The CEOs said, that in determining tax policy for employee benefit plans, Congress should be more concerned about the economic security of U.S. workers than any other consideration. They ranked health care cost containment as a second concern and employee access to quality health care services as their third concern. Reducing the federal deficit ranked fourth.

Detailed Findings

Section 1: Employee Benefits, Tax Preferences and the Federal Deficit

Reasons for Sponsoring Employee Benefit Plans

The principal reason why their companies sponsor employee benefit plans, say the chief executives surveyed, is the "need to remain competitive in the labor marketplace and attract good employees." The "desire for good employee relations" and concern for employees' economic security also were considered very important. The least important reason was the tax deductibility of a company's expenses incurred to provide these benefits.

Question 1:Please rank the reasons why, in your opinion, your company sponsors employee benefit plans (#1 representing the most important, #2 the next most important, etc.).

Weighted Rank Order		Ranked #1	Ranked #2	Ranked #3	Rank* Points
1	Need to remain competitive in Labor marketplace and attract good employees	258	114	66	1,068
2	Concern for economic security of employees	149	100	113	760
3	Desire for good employee relations	70	186	144	726
4	Tax-effectiveness of benefits to employees (compared to direct compensation)	9	35	55	152
5	Belief that benefits improve productivity	4	33	56	134
6	Tax deductibility of benefit costs by company	3	19	35	82

* Findings based on rank points: 3 points for every #1 ranking, 2 points for every #2, 1 point for every #3.

Importance of Reducing Federal Deficit

There is near unanimity of executive opinion on the need to reduce the federal deficit. A majority (65 percent) termed the need "crucial."

Question 2: Thinking broadly for a moment about the nation's deficit, how important, in your opinion, are current efforts to reduce the deficit?

Crucial	65%
Important	35%
Unimportant	1%

Taxing Employee Benefits

Although the tax deductibility of company benefit costs was considered the least important reason for sponsoring a benefit plan, a sizeable majority—81 percent—expressed the view that reducing or eliminating tax preferences for employee benefits is **not** a sensible approach to increasing revenues. Sixty-nine percent reported that the favorable tax treatment granted benefit plans has been influential in encouraging their companies to sponsor these plans, and 87 percent indicated that existing tax preferences for benefit plans should remain unaltered.

Question 3: Please circle the number which best reflects your own opinion on each of the following statements:

	Strongly Agree	Tend to Agree	Tend to Disagree	Strongly Disagree	No Opinion
Eliminating some of the tax preferences for employee benefits (to both employers and employees) is a sensible approach to increaseing revenues and reducing the federal deficit.	3%	15%	31%	50%	1%
The current policy of providing tax preferences for employer-sponsored employee benefit programs should remain intact.	52%	35%	11%	1%	1%
The current policy of providing tax preferences for employer-sponsored employee benefit programs should be changed.	3%	14%	39%	41%	3%
Tax preferences for employee benefits have been influential in encouraging my company to sponsor employee benefit plans.	30%	39%	13%	10%	8%

Section 2: The Effect of Tax Change on Employees and the Structure of Benefit Plans

Reactions to Eliminating Benefit Tax Preferences

If Congress were to eliminate or reduce the tax preferences for benefit plans, 41 percent of the executives surveyed believe that companies **in general** would tend to cut back on benefits but leave direct compensation unchanged—producing a net decrease in employees' total (direct and indirect) compensation. Fifty-five percent would either continue benefits without material change or would reduce benefits and add the value to direct compensation.

Question 4: If Congress were to eliminate many of the tax preferences for employee benefits, how do you believe U.S. companies would generally react?

Would continue to provide benefits without material change, much as they do now	30%
Would cut benefits back but increase direct compensation so total would remain constant	25%
Would cut benefits back and leave direct compensation unchanged so total would be reduced	41%
No opinion	4%

Question 5: How do you think your company would react if Congress were to eliminate many of the tax preferences for employee benefits?

Would continue to provide benefits without material change, much as they do now	47%
Would cut benefits back but increase direct compensation so total would remain constant	21%
Would cut benefits back and leave direct compensation unchanged so total would be reduced	28%
No opinion	4%

Reactions to Increasing Cash Compensation

If their companies increased salaries in lieu of reduced benefits, 88 percent of the executives indicated that they did not think employees would invest this additional compensation to ensure their future financial security. Three-fourths of the executives believed that their employees would not use the additional income to purchase personal replacement insurance.

Question 6: Please indicate whether you agree or disagree with the following statement: If my company were to increase salaries to make up for reduced benefits, most employees would:

	Strongly Agree	Tend to Agree	Tend to Disagree	Strongly Disagree	No Opinion
Invest the money to ensure their future financial security	1%	10%	50%	38%	1%
Purchase replacement insurance on their own	2%	23%	51%	23%	1%

Eliminating Benefit Tax Preferences: Where Greatest Burden Would Fall

Hourly wage earners and administrative workers are the two categories of employees which would be most affected by the elimination of the tax-favored status of benefit programs, in the view of the executives surveyed. Top and middle management would be the least affected groups.

Question 7: If Congress were to eliminate many of the tax preferences for employee benefits, please rank how the following employee groups could be affected (#1 representing the most affected, #2 the next most affected, etc.).

Weighted Rank Order		Ranked #1	Ranked #2	Ranked #3	Rank* Points
1	Hourly	195	38	16	677
2	Administrative/Clerical	71	191	39	625
3	Middle Management	54	150	92	554
4	Top Management	149	32	33	544
5	Other Professionals	13	65	285	454

* Findings based on rank points: 3 points for every #1 ranking, 2 points for every #2, 1 point for every #3.

Awareness of Employee Benefit Program Tax Effectiveness

A substantial majority of the chief executives surveyed (85 percent) believe that most employees are unaware of the present tax effectiveness of employee benefits.

Question 8: Do you agree or disagree with the following statement: Most employees are unaware of the current tax effectiveness of employee benefits.

Strongly agree	36%
Tend to agree	49%
Tend to disagree	11%
Strongly disagree	4%
No opinion	0%

Types of Tax-Favored Benefits Sponsored

Of the companies surveyed, the benefits provided to employees on a tax-favored basis by the largest number of employers include: retirement plans, group medical insurance, group life insurance and disability insurance.

Fifty-three percent of the employers report that their organizations sponsor a 401(k) program allowing employees to save part of their earnings on a before-tax basis.

Question 9: Which of the following benefits (providing employees with tax advantages) does your company sponsor? (Check all that apply.)

Retirement plans (pension and/or profit sharing)	95%
Group medical insurance	99%
Group life insurance	98%
Disability insurance	87%
Thrift or saving plans (employee contributions are post-tax, but employer contributions and earnings are sheltered)	39%
401(k) pre-tax saving plans (all contributions and earnings sheltered)	53%
Flexible spending accounts providing pre-tax reimbursement of medical expenses	10%
Flexible spending accounts providing pre-tax reimbursement of other expenses (dependent care, etc.)	6%

Anticipated Union Reaction to Elimination of Benefit Tax Preferences

Almost half of the chief executives (48 percent) believe they will be asked by union leaders to maintain existing benefit plans if Congress eliminates the favorable tax status of employee benefits. (Thirty percent of the executives indicated that their work forces are non-unionized.)

Question 10: If part of your company's work force is unionized, what do you anticipate union leaders would do if Congress eliminated many tax preferences for employee benefits?

Ask employers to maintain existing benefit plans	48%
Ask employers to increase direct compensation to make up for reduced benefits	18%
Do nothing as long as total compensation stayed the same	4%
Accept reduced total compensation resulting from employer-paid benefits becoming taxable income to employees	0%
No unionized work force at my company	30%

Loss of Tax Preferences—Effects on Employees and Retirees

Almost nine of every ten chief executives feel that the loss of tax preferences for employee benefits would have a negative effect on the health and welfare of workers and their families.

As for the economic security of retired workers, 86 percent feel that a similar negative effect will result.

Question 11: From an employer's point of view, what effect do you feel eliminating many tax preferences for employee benefits would have on:

	Very Negative	Somewhat Negative	No Effect	Somewhat Positive	Very Positive
The health and welfare of active workers and their families	28%	61%	10%	.5%	.5%
The economic security of retired workers	43%	43%	14%	0%	0%

Restructuring Benefits: What Congress Should Consider

Chief executives agree overwhelmingly that Congress should be concerned with the economic security of employees when it considers restructuring employee benefit tax policy.

The containment of rising health care costs and employee accessibility to quality health care are two other areas that employers believe should be considered as the employee benefit taxation issue is debated by Congress.

Question 12: Please rank what, in your opinion, ought to be of greatest concern to Congress when it restructures employee benefit tax policy (#1 representing the greatest concern, #2 the next most important, etc.).

Weighted Rank Order		Ranked #1	Ranked #2	Ranked #3	Rank* Points
1	Economic security of employees	205	102	65	884
2	Containment of escalating health care costs	95	101	98	585
3	Employee access to quality health services	68	111	97	523
4	Federal deficit reduction	57	40	50	301
5	Continued growth of the private pension system	35	55	51	266
6	Support for growing number of retired workers	16	43	75	209
7	Employee flexibility in selecting benefits	12	32	28	128

* Findings based on rank points: 3 points for every #1 ranking, 2 points for every #2, 1 point for every #3

Order of Priorities in Changing Tax Climate

If tax deductions for employer contributions to benefits were reduced, or if those contributions were made taxable to employees, the chief executives say Congress should change the favorable tax treatment of flexible compensation plans before doing so for welfare or retirement plans.

Question 13: In the event that allowable deductions for employer payments for benefits are reduced, or if those contributions become taxable income to employees, check the type of benefit plan that, in your opinion, should be taxed first:

Flexible compensation plans	First
Savings plans (where withdrawals can be made before retirement)	Second
Welfare plans (health, life, disability, etc.)	Third
Retirement plans	Fourth

IRAs, 401(k)'s and Employer-Sponsored Thrift and Savings Plans

The employers surveyed unanimously support tax-sheltered savings plans (IRAs, 401(k)s, etc.) and employer-sponsored thrift and savings plans because employees must be encouraged to save for their retirement.

Sixty-nine percent say they support such plans because of the tax-preferences provided to executives and high-paid employees at little cost to the company.

Chief executive opinion was divided on the rules and regulations governing tax-sheltered plans. While half agree that the rules for these plans should be tightened to allow only pay-outs for retirement or serious emergencies, 46 percent say the rules should be loosened so that funds can be made available for home purchases, college education, etc.

Moreover, 88 percent agree that these tax-sheltered plans are worth the loss of revenues which would otherwise be generated. However, 56 percent agree that these savings plans, while basically good, should be modified to prevent tax abuses.

Question 14: Many workers have tax-sheltered savings in Individual Retirement Accounts and in 401(k) pre-tax savings plans, tax-sheltered annuities and other employer-sponsored thrift and savings plans. Please circle the number which best reflects your opinion on each of the following statements:

	Strongly Agree	Tend to Agree	Tend to Disagree	Strongly Disagree	No Opinion
I support such plans because employees must be encouraged to save for their retirement; employers and Social Security cannot do it all	86%	14%	0%	0%	0%
I support such plans because they provide attractive tax preferences for executives and higher-paid employees at little cost to the company	22%	47%	18%	10%	3%
Rules for these plans should be tightened so that money is not used as all-purpose savings, but only for retirement or serious emergencies	11%	40%	32%	16%	1%
Rules for these plans should be loosened so money is available for home purchases, college educations, etc	11%	35%	38%	13%	3%
These plans are not worth the loss of tax revenues which would otherwise be generated	2%	6%	23%	65%	4%
Tax preferences for these plans should be reduced because revenue loss is too great.	1%	5%	32%	60%	2%
Tax preferences for these plans should be reduced because they disproportionately benefit higher-paid employees	1%	7%	39%	51%	2%
Such savings programs are basically good, but should be modified to prevent abuses	7%	49%	24%	14%	6%

Section 3: Views are Split on Capping Employer Contributions

Capping Employer-Paid Health Insurance Premiums

In an open-ended question inviting comments, 56 percent of the respondents voiced opposition to placing a dollar cap on the amount of tax-free employer-paid health insurance an employee can receive. Some representative comments citing this opposition include:

- "A cap would cause internal inequities between employees as well as geographic inequities;"
- "A cap would not contain the rising cost of health care which is the real problem;"
- "Government should not interfere with business."

Thirty-nine percent favored the use of a cap. Explaining why they favored limiting the dollar amount of employer-provided health coverage an employee can receive on a tax-favored basis, respondents offered comments such as:

- "A cap would force the medical industry to provide cost-effective medical care. It would decrease the cost of health care;"
- "Caps would increase employees' awareness of the costs of benefits incurred by the employer."

If a dollar cap were enacted and their organizations' health insurance premium payments exceeded the cap, 44 percent of the employers say they would establish a second health benefit plan and offer employees the alternative coverage with lower premiums (at or below the cap limit).

Question 15*: Would you favor or oppose proposals to place a cap on employer-paid health insurance premiums? (All amounts over the limit would be taxable income to the employees.)

Favor: 39% Oppose: 56% No opinion: 5%

*Open-ended question that solicited comments

Question 16: If a cap was enacted and your company's current payments for health insurance premiums exceeded the dollar cap amount, how do you think your company would react?

Reduce its contributions to the health benefit plan so that they fell within the dollar cap	22%
Establish a second health benefit plan with the company's contributions falling within the dollar cap amount and offer employees a choice between the current plan and this second plan	44%
Leave the existing plan unchanged	34%

Capping Employer Contributions for "Other" Benefits

In another open-ended question, 70 percent of the respondents expressed opposition to the idea of limiting the amount of employer contributions to benefits such as pensions and profit-sharing plans, which employees can receive on a tax-free basis. Employer contributions above the limit would be taxable income to employees, and a representative comment from respondents was:

- "This type of cap would be unfair to the lower-paid and long-term employees."

When asked to rank (according to fairness) several caps limiting the amount of tax-free funds employees could receive, the employers selected a flat-dollar cap indexed to inflation as the most reasonable, followed by a non-indexed flat-dollar cap.

Question 17*: Would you favor or oppose proposals to place a cap on employer contributions to "other" benefits such as pensions, profit-sharing, etc.?

Favor: 22% Oppose: 70% No opinion: 8%

*Open-ended question that solicited comments.

Question 18: Please rank the following types of caps on the basis of how fairly you believe they would limit the amount employees could receive on a tax-free basis. (#1 representing the most fair, etc.)

Weighted Rank Order		Ranked #1	Ranked #2	Ranked #3	Rank* Points
1	Flat-dollar cap indexed to inflation	281	103	28	1,077
2	Flat-dollar cap (same for all employees)	86	201	63	723
3	Cap determined on the basis of employee geographic location	50	32	134	348
4	Cap determined on the basis of employee age	34	45	148	340

* Findings based on rank points: 3 points for every #1 ranking, 2 points for every #2, 1 point for every #3.

Section 4: Effect on Capital Markets

Pension Plan Assets and U.S. Capital Markets

With private tax-qualified pension plan assets now exceeding $900 billion, 87 percent of the chief executives believe a change in the tax status of these funds would affect U.S. capital markets and capital formation.

Question 19: Currently, assets of U.S. private tax-qualified pension plans amount to over $900 billion. To what extent to you believe a change in the tax-preferenced status of these funds would affect U.S. capital markets and capital formation?

To a great extent	41%
To some extent	46%
Hardly at all	11%
Not at all	2%

Section 5: Reduction of Benefits will Press Social Security System

Prospective Cutbacks in Benefit Programs

Similar to the response to Question 4, 79 percent of the chief executives agree that if the tax preferences for employee benefits are eliminated, U.S. companies for the most part will cut back on their employee benefit programs.

Of the 79 percent that agree, 72 percent believe that a reduction in employee benefit programs by employers will place additional pressure on the government to increase Social Security and welfare benefits.

Question 20a: Do you agree or disagree with the following statement: If many tax preferences for employee benefits are eliminated, the majority of U.S. employers will reduce their employee benefit programs.

Strongly agree	22%
Tend to agree	57%
Tend to disagree	18%
Strongly disagree	3%

Question 20b: If you strongly agree or tend to agree that the majority of employers will reduce their benefit programs, do you believe that this will put pressure on the government to increase Social Security and/or provide additional welfare benefits?

Yes: 72% No: 21% No opinion: 7%

Section 6: Tax Preferences and the Future of Benefits—a Message to Congress

Future of Employee Benefits

If the tax-favored status of employee benefits is reduced, 57 percent of the respondents anticipate that their companies' total benefit programs will shrink by 1990. Over one-third, however, thought their programs would remain unchanged.

Question 21: If many tax preferences for employee benefits are eliminated, do you anticipate that your company's total benefit program will shrink, expand, or stay relatively unchanged by 1990?

Expand significantly	0%
Expand a little	8%
Shrink an little	43%
Shrink significantly	14%
Stay the same	35%

Employee Benefits by 1990—Some Specifics

Employers were also asked to review 15 individual employee benefits and to consider whether they would increase or decrease within their company's overall benefit packages by 1990—based on both the existing favorable tax status of benefits and on a more restrictive tax restructuring.

Even with continuing favorable tax treatment, the majority of CEOs expect 13 of the 15 benefits to remain the same. Only flexible benefits and 401(k) plans are expected to be increased by the majority of respondents.

A minority of the CEOs expect all benefits to increase while only a few expect benefits to decrease. The one exception is health benefits, which 29 percent expect to decrease.

If tax preferences are reduced, a greater number of CEOs expect benefits to remain the same or to be decreased, while a much smaller number expect benefits to be increased.

While a variety of conclusions might be drawn from these responses, there appears to be a general levelling off in the pace at which benefits are being increased, a few areas of income security are still seen to need improvement, and benefits are not likely to be reduced by management or by unions, except for health care coverages. In the latter case, rapidly increasing medical costs are being addressed by employers who are reducing benefits regardless of tax preferences.

However, if tax preferences are reduced or eliminated, a substantial shift can be expected with decreases being made in all income security benefits. The percentage of respondents predicting a decrease in the 15 benefits outweighs the respondents who see an increase by a ratio of 4 to 1.

Moreover, while 6 percent of the executives anticipate an increase in health benefits by 1990, 60 percent predict a decrease if tax preferences are eliminated or reduced. With a changed tax status for employee benefits, 9 percent of the respondents predict increased company contributions to thrift plans, but one-third say they will be decreased.

Question 22: For each of the following employee benefits, please indicate whether you anticipate the benefit to be increased or decreased by your company over the next six years (by 1990):

Type of Benefit	If Tax Preferences Are Unchanged			If Tax preferences Are Reduced or Eliminated		
	Increased	Decreased	Stay The Same	Increased	Decreased	Stay The Same
Health Benefits	24%	29%	47%	6%	60%	34%
Vacation Time	20%	3%	77%	11%	10%	79%
Child care benefits	42%	1%	57%	12%	17%	71%
Educational benefits	23%	5%	72%	7%	26%	67%
Legal benefits	19%	0%	81%	2%	16%	82%
Life insurance benefits	35%	4%	61%	10%	29%	61%
Company contributions to thrift/savings plans	40%	3%	57%	9%	33%	58%
Disability benefits	29%	2%	69%	8%	22%	70%
Dental benefits	35%	6%	59%	9%	30%	61%
Prescription drug benefits	19%	7%	74%	3%	27%	70%
Vision benefits	32%	3%	65%	6%	24%	70%
Flexible benefits	52%	1%	47%	17%	26%	57%
Pensions	33%	7%	60%	10%	24%	66%
Profit-sharing plans	25%	3%	72%	6%	31%	63%
Salary reduction plans—401(k)	54%	1%	45%	17%	35%	48%

Changing Employer/Employee Relationships

Question 23: If employee benefit plans are reduced because of tax changes, how do you foresee the employer/employee relationship changing?

In open-ended responses to this question, the chief executives most often cited poor morale, low productivity, increased hostility, turnover and other adverse situations as the result of reduced employer-sponsored benefit programs.

Classification Data of Companies Surveyed

Question 24: Type of company (please check appropriate category):

4%	Agricultural
2%	Automotive and Auto Supplies
9%	Banking/Financial
2%	Chemical
2%	Communications
3%	Consumer Products & Packaged Goods (Non-food)
3%	Construction
6%	Diversified/Conglomerate
4%	Electronics
4%	Energy
2%	Food Products
14%	Hospital/Health Care
4%	Hotels & Lodging
2%	Metals
4%	Petroleum
9%	Other Manufacturing
3%	Retailing
2%	Textiles
4%	Transportation
28%	Other (specify)

Question 25: Size of Company by sales:

23%	Less than $100 million
15%	$100 million to under $200 million
11%	$200 million to under $400 million
20%	$400 to under $1 billion
22%	$1 billion to under $5 billion
9%	$5 billion and over

Question 26: Number of employees

8%	Under 1,000
46%	1,001 to 5,000
20%	5,001 to 10,000
12%	10,001 to 20,000
9%	20,001 to 50,000
5%	Over 50,000

Question 27: About what percentage of your company's work force is unionized? 15%.

Question 28: Please circle one of the geographic codes below that best describes where most of your employees work. If your group is located in two or more of these regions, please circle either "6" or "7" for NATIONAL or MULTINATIONAL, whichever is most appropriate.

Northeast	15%	1	— Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New York, New Jersey, Pennsylvania, Delaware, Maryland, Washington, DC.
South	15%	2	— Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Kentucky, Tennessee, Alabama, Mississippi, Arkansas, Louisiana
Midwest	18%	3	— Ohio, Indiana, Illinois, Michigan, Wisconsin, Minnesota, Iowa, Missouri, Nebraska, North Dakota, South Dakota, Kansas
Southwest	5%	4	— Oklahoma, Texas, New Mexico, Arizona
West	11%	5	— Montana, Idaho, Wyoming, Colorado, Utah, Nevada, Washington, Oregon, California, Alaska, Hawaii
National	24%	6	
Multinational	10%	7	

Question 29: Is your company a public corporation or privately owned?

Public: 68% Private: 35%

Original Survey Questionnaire

EMPLOYER ATTITUDES TOWARD EMPLOYEE BENEFITS AND TAX CHANGE

William M. Mercer-Meidinger, Incorporated's 1984 "employer attitude" survey is designed to elicit the views of chief executive officers on possible tax changes affecting employee benefits and how these changes could affect employer-sponsored benefit programs and income security for employees.

1. Please rank the reasons why, in your opinion, your company sponsors employee benefit plans (#1 representing the most important, #2 the next most important, etc.)

______ Concern for economic security of employees
______ Desire for good employee relations
______ Belief that benefits improve productivity
______ Need to remain competitive in labor marketplace and attract good employees
______ Tax deductibility of benefit costs by company
______ Tax-effectiveness of benefits to employees (compared to direct compensation)

2. Thinking broadly for a moment about the nation's deficit, how important, in your opinion, are current efforts to reduce the deficit?

______ Crucial
______ Important
______ Unimportant

3. Please circle the number which best reflects your own opinion on each of the following statements:

	Strongly Agree	Tend to Agree	Tend to Disagree	Strongly Disagree	No Opinion
a. Eliminating some of the tax preferences for employee benefits (to both employers and employees) is a sensible approach to increasing revenues and reducing the federal deficit.	1	2	3	4	5
b. The **current** policy of providing tax preferences for employer-sponsored employee benefit programs should remain intact.	1	2	3	4	5
c. The current policy of providing tax preferences for employer-sponsored employee benefit programs should be changed.	1	2	3	4	5
d. Tax preferences for employee benefits have been influential in encouraging my company to sponsor employee benefit plans.	1	2	3	4	5

4. If Congress were to eliminate many of the tax preferences for employee benefits, how do you believe **U.S. companies** would generally react?

______ Would continue to provide benefits without material change, much as they do now
______ Would cut benefits back but increase direct compensation so total would remain constant
______ Would cut benefits back and leave direct compensation unchanged so total would be reduced
______ No opinion

5. How do you think **your company** would react if Congress were to eliminate many of the tax preferences for employee benefits?

______ Would continue to provide benefits without material change, much as they do now
______ Would cut benefits back but increase direct compensation so total would remain constant
______ Would cut benefits back and leave direct compensation unchanged so total would be reduced.
______ No opinion

6. Please indicate whether you agree or disagree with the following two-part statement: If my company were to increase salaries to make up for reduced benefits, most employees would:

   a) invest the money to ensure their future financial security.
      ______ Strongly agree
      ______ Tend to agree
      ______ Tend to disagree
      ______ Strongly disagree
      ______ No opinion

   b) purchase replacement insurance on their own.
      ______ Strongly agree
      ______ Tend to agree
      ______ Tend to disagree
      ______ Strongly disagree
      ______ No opinion

7. If Congress were to eliminate many of the tax preferences for employee benefits, please rank the following employee groups which would be most affected (#1 representing the most affected, #2 the next most affected, etc.).

   ______ Top management
   ______ Middle management
   ______ Other professionals
   ______ Administrative/clerical
   ______ Hourly

8. Do you agree or disagree with the following statement: Most employees are unaware of the current tax effectiveness of employee benefits.

   ______ Strongly agree
   ______ Tend to agree
   ______ Tend to disagree
   ______ Strongly disagree
   ______ No opinion

9. Which of the following benefits providing employees with tax advantages does your company sponsor? (Check all that apply)

   ______ Retirement plans (pension and/or profit-sharing)
   ______ Group medical insurance
   ______ Group life insurance
   ______ Disability insurance
   ______ Thrift or savings plan (employee contributions are post-tax but employer contributions and earnings are sheltered)
   ______ 401(k) pre-tax savings plan (all contributions and earnings are sheltered)
   ______ Flexible spending account providing pre-tax reimbursement of medical expenses
   ______ Flexible spending account providing pre-tax reimbursement of other expenses (dependent care, etc.)

10. If part of your company's work force is unionized, what do you anticipate union leaders would do if Congress eliminated many tax preferences for employee benefits?

   ______ Ask employers to maintain existing benefit plans
   ______ Ask employers to increase direct compensation to make up for reduced benefits
   ______ Do nothing as long as total compensation stayed the same
   ______ Accept reduced total compensation resulting from employer-paid benefits becoming taxable income to employees
   ______ No unionized work force at my company

11. From an **employer's** point of view, what effect do you feel eliminating many tax preferences for employee benefits would have on:

   a. the health and welfare of active workers and their families?
      ______ Very negative
      ______ Somewhat negative
      ______ No effect
      ______ Somewhat positive
      ______ Very positive

   b. the economic security of retired workers?
      ______ Very negative
      ______ Somewhat negative
      ______ No effect
      ______ Somewhat positive
      ______ Very positive

12. Please rank what, in your opinion, ought to be of greatest concern to Congress when it restructures employee benefit tax policy (#1 representing the greatest concern, #2 the next most important, etc.)

______ Economic security of employees
______ Employee access to quality health services
______ Support for a growing number of retired workers
______ Federal deficit reductions
______ Containment of escalating health care costs
______ Employee flexibility in selecting benefits
______ Continued growth of the private pension system

13. In the event that allowable deductions for employer payments for benefits are reduced, or if those contributions become taxable income to employees, check the type of benefit plan in **each** of the following pairs that, in your opinion, **should** be taxed first:

______	Welfare plans (health, life, disability, etc.)	OR	______	Retirement plans (pension, profit-sharing, thrift)
______	Welfare plans	OR	______	Flexible compensation plans
______	Welfare plans	OR	______	Savings plans (where withdrawals can be made before retirement)
______	Retirement plans	OR	______	Flexible compensation plans
______	Retirement plans	OR	______	Savings plans
______	Flexible compensation plans	OR	______	Savings plans

14. Many workers have tax-sheltered savings in Individual Retirement Accounts and in 401(k) pre-tax savings plans, tax-sheltered annuities and other employer-sponsored thrift and savings plans. Please circle the number which best reflects your opinion on each of the following statements:

	Strongly Agree	Tend to Agree	Tend to Disagree	Strongly Disagree	No Opinion
a. I support such plans because employees must be encouraged to save for their retirement; employers and Social Security cannot do it all.	1	2	3	4	5
b. I support such plans because they provide attractive tax preferences for executives and higher-paid employees at little cost to the company.	1	2	3	4	5
c. Rules for these plans should be tightened so that money is not used as all-purpose savings, but only for retirement or serious emergencies.	1	2	3	4	5
d. Rules for these plans should be loosened so money is available for home purchases, college educations, etc.	1	2	3	4	5
e. These plans are not worth the loss of tax revenues which would otherwise be generated.	1	2	3	4	5
f. Tax preferences for these plans should be reduced because revenue loss is too great.	1	2	3	4	5
g. Tax preferences for these plans should be reduced because they disproportionately benefit higher-paid employees.	1	2	3	4	5
h. Such savings programs are basically good, but should be modified to prevent abuses.	1	2	3	4	5

15. Would you favor or oppose proposals to place a cap on employer-paid **health insurance premiums**? (All amounts over the limit would be taxable income to the employee.)

______ Favor ______ Oppose ______ No opinion

Why? ______________________________

____

____

16. If a cap was enacted and your company's current payments for health insurance premiums **exceeded** the dollar cap amount, how do you think your company would react?

______ Reduce its contribution to the health benefit plan so that they fell within the dollar cap.
______ Establish a second health benefit plan with the company's contributions falling within the dollar cap amount and offer employees a choice between the current plan and this second plan.
______ Leave the existing health plan unchanged.

17. Would you favor or oppose proposals to place a similar cap on employer contributions to **other benefits** such as pensions, profit-sharing plans, etc.?

______ Favor ______ Oppose ______ No opinion

Why? ______________________________

____

____

18. Please rank the following types of caps on the basis of how fairly you believe they would limit the amount employees could receive on a tax-free basis. (#1 representing the most fair, etc.)

______ Cap determined on the basis of age
______ Cap determined on the basis of employee geographic location
______ Flat dollar cap (same for all employees)
______ Flat dollar cap indexed to inflation

19. Currently assets of U.S. private tax-qualified pension plans amount to over $500 billion. To what extent do you believe a change in the tax-preferenced status of these funds would affect U.S. capital markets and capital formation?

______ To a great extent
______ To some extent
______ Hardly at all
______ Not at all

20. a. Do you agree or disagree with the following statement: If many tax preferences for employee benefits are eliminated, the majority of U.S. employers will reduce their employee benefit programs.

______ Strongly agree
______ Tend to agree
______ Tend to disagree
______ Strongly disagree
______ No opinion

b. If you strongly agree or tend to agree that the majority of employers will reduce their benefit programs, do you believe that this will put pressure on the government to increase Social Security and/or provide additional welfare benefits?

______ Yes ______ No ______ No opinion

21. If many tax preferences for employee benefits are eliminated, do you anticipate that **your company's** total benefit program will shrink, expand or stay relatively unchanged by 1990?

_____ Expand significantly
_____ Expand a little
_____ Stay the same
_____ Shrink a little
_____ Shrink significantly

22. For each of the following employee benefits, please indicate whether you anticipate the benefit to be increased or decreased by your company over the next six years (by 1990):

a. If tax preferences for employee benefits remain **unchanged**

	Increased	Decreased	Stay the Same
Health benefits	1	2	3
Vacation time	1	2	3
Child care benefits	1	2	3
Educational benefits	1	2	3
Legal benefits	1	2	3
Life insurance benefits	1	2	3
Company contributions to thrift/savings plans	1	2	3
Disability benefits	1	2	3
Dental benefits	1	2	3
Prescription drug benefits	1	2	3
Vision benefits	1	2	3
Flexible benefits	1	2	3
Pensions	1	2	3
Profit-sharing plans	1	2	3
Salary reduction plans—401(k)	1	2	3

b. If tax preferences for employee benefits are **reduced** or **eliminated**

	Increased	Decreased	Stay the Same
Health benefits	1	2	3
Vacation time	1	2	3
Child care benefits	1	2	3
Educational benefits	1	2	3
Legal benefits	1	2	3
Life insurance benefits	1	2	3
Company contributions to thrift/savings plans	1	2	3
Disability benefits	1	2	3
Dental benefits	1	2	3
Prescription drug benefits	1	2	3
Vision benefits	1	2	3
Flexible benefits	1	2	3
Pensions	1	2	3
Profit-sharing plans	1	2	3
Salary reduction plans—401(k)	1	2	3

23. If employee benefit plans are reduced because of tax changes, how do you foresee the employer/employee relationship changing?

____

____

____

CLASSIFICATION DATA

Please complete the following information about your company. Answers will be used for analysis purposes only.

24. Type of company (please check appropriate category):

_____ Agricultural
_____ Automotive and Auto Supplies
_____ Banking/Financial
_____ Chemical
_____ Communications
_____ Consumer Products & Packaged Goods (non-food)
_____ Construction
_____ Diversified/Conglomerate
_____ Electronics
_____ Energy
_____ Food Products
_____ Hospital/Health Care
_____ Hotels & Lodging
_____ Metals
_____ Petroleum
_____ Other Manufacturing
_____ Retailing
_____ Textiles
_____ Transportation
_____ Other (specify)

25. Size of company by sales:

_____ Less than $100 million
_____ $100 million to under $200 million
_____ $200 million to under $400 million
_____ $400 to under $1 billion
_____ $1 billion to under $5 billion
_____ $5 billion and over

26. Number of employees

_____ Under 1,000
_____ 1,001 to 5,000
_____ 5,001 to 10,000
_____ 10,001 to 20,000
_____ 20,001 to 50,000
_____ Over 50,000

27. About what percent of your company's work force is unionized? __________%

28. Please circle one of the geographic codes below that best describes where most of your employees work. If your group is located in two or more of these regions, please circle either "6" or "7" for NATIONAL or MULTINATIONAL, whichever is most appropriate

NORTHEAST	1	— Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New York, New Jersey, Pennsylvania, Delaware, Maryland, Washington, D.C.
SOUTH	2	— Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Kentucky, Tennessee, Alabama, Mississippi, Arkansas, Louisiana
MIDWEST	3	— Ohio, Indiana, Illinois, Michigan, Wisconsin, Minnesota, Iowa, Missouri, Nebraska, North Dakota, South Dakota, Kansas
SOUTHWEST	4	— Oklahoma, Texas, New Mexico, Arizona
WEST	5	— Montana, Idaho, Wyoming, Colorado, Utah, Nevada, Washington, Oregon, California, Alaska, Hawaii
NATIONAL	6	
MULTINATIONAL	7	

29. Is your company a public corporation or privately owned?

_____ Public _____ Private

Multiple-Option Flexible Benefit Plans

A Mercer-Meidinger Survey

WILLIAM M.
MERCER - Meidinger
INCORPORATED

In late June 1984, a survey was conducted of 45 companies that currently have multiple-option flexible benefit programs. Twenty-three of these companies responded to the survey. These respondents had plans covering over 250,000 employees, ranging in size from under 200 employees to 85,000 employees. The median size plan among the respondents covered 7,000 employees.

Part 1 of this report provides details on the responses to the survey. Part 2 provides a list of participating companies.

Key findings of the survey are summarized as follows:

- Over 60 percent of the respondents implemented a flexible benefit program between 1982 and 1984.

- Approximately 56 percent of the respondents also implemented Flexible Spending Accounts between 1982 and 1984.

- Two-thirds of the respondents identified cost containment as a major motivating factor in implementing flexible benefits. The two factors next most important in motivating sponsorship of flexible plans were to give employees greater choice and to foster employee relations.

- The most common coverages included in the programs were Medical, Dental, Life, Long Term Disability, Dependent Care, and 401(k), in that order.

- Over one-third of the respondents would have communicated their programs more extensively if they were starting up their program today. A slightly lower number said they would do nothing differently.

- Over one-half of the respondents added one to five additional staff employees to help administer their flexible benefit programs.

PART 1 — SURVEY RESPONSES

DECISION TO IMPLEMENT FLEXIBLE BENEFIT PROGRAMS

The primary reason cited for implementing flexible benefit programs among the 23 corporate employers responding to this survey is their desire to encourage the containment of rising benefit costs. Eight respondents rank cost containment their number one reason for sponsoring a flexible benefit plan. The second and third most important factors cited were to provide employees with greater choice and to foster employee relations.

Question 1: Why did your company decide to implement a flexible benefits program?

Rank	Motivating Factor For Plan Implementation	No. Ranking #1	No. Ranking #2	No. Ranking #3	No. Ranking #4	Total (Top 4)
1	Encourage cost containment	8	7	1	0	16
2	Give employees greater choice	5	5	3	0	13
3	Foster employee relations	5	3	3	1	12
4	Maintain or enhance competitive posture	2	0	2	2	6
5	Add new coverages at low cost to company	1	0	1	2	4
6	Distinguish between union and non-union benefit programs	0	0	0	1	1
	(Not answering this question - 2)					

In most instances the idea to implement a flex program was initiated by the benefits/personnel departments.

Question 2: Who initiated the idea to implement a flex program?

Initiating Idea	Number of Companies
CEO	3
Senior Management	8
Benefits Department	13
Finance Department	0
Consultant	3
Other: 3 from human resource department, 2 from personnel department	5

Over 60 percent of the respondents decided to implement a flexible benefit program during the years 1981 and 1982. Only three companies developed a flexible approach before 1979.

Question 3: When was the idea to conceive a flexible benefit program conceived?

Year	Number of Companies Conceiving plan in Year
1970-1978	3
1979	3
1980	3
1981	6
1982	8
1983	0
Total	23

FEASIBILITY STUDIES

Eighteen companies (78.3 percent) conducted studies to determine the feasibility of implementing a flexible compensation program.

Question 4: Did you conduct a feasibility study?

	Number of Companies
Yes	17
No	6

Of the companies who conducted feasibility studies, over 40 percent completed their feasibility investigation in less than three months and over 70 percent in less than six months.

Question 5: How long did the study take?

Time Period	Number of Companies
A few weeks	1
1-3 months	6
3-6 months	5
6-9 months	4
over 9 months	1
Not applicable	6

Seventy-six percent of the studies conducted included employee attitude testing.

Question 6: Did the study include employee attitude testing?

	Number of Companies
Yes	13
No	3
Not answering	1
Not applicable	6

Over one-third of the feasibility studies utilized focus groups; slightly fewer utilized questionnaires.

Question 7: If employee attitudes were tested, what method was used?

Method Used	Number of Companies
Focus Groups (i.e. small group meetings)	6
Questionnaire	4
Both	4
Not answering	3
Not applicable	6

Fifty-two percent of the companies pre-tested employee election patterns based on preliminary plan designs.

Question 8: Did you pre-test employee election patterns based on preliminary plan design?

	Number of Companies
Yes	12
No	11

Of the companies that pre-tested employees, all found the actual election distribution to be similar to the test results.

Question 9: Were employee election testing results similar to actual elections during implementation?

	Number of Companies
Yes	12
No	0
Not applicable	11

Of the companies that made changes as a result of employee election testing, most changes were in the plan design and communications areas.

Question 10: Did employee election testing result in any changes in the following:

Where Changes Occurred	Number of Companies
Plan Design	6
Pricing	3
Communications	5
No changes	6
Other	1
Not applicable	8

IMPLEMENTATION, DESIGN AND EVALUATION OF FLEXIBLE PLANS

Nearly three quarters of the respondents implemented their flexible benefit plan between 1982 and 1984. Only five plans became effective before 1982. One plan was implemented in 1973.

Question 11: When was the program actually implemented?

Year	Number of Plans Implemented
1973	1
1980	1
1981	3
1982	5
1983	6
1984	6
Not applicable	1

Before implementing the flexible benefits program, 65 percent of the companies viewed their benefit plans as above average.

Question 12: Before implementing the flexible benefits program, did you view your benefit plan as:

Quality of Benefit Plans	Number of Companies
Below Average	0
Average	8
Above Average	15

Most companies hired a consulting firm to assist in plan design, communications, conduct of the feasibility study, and/or pricing.

Question 13: Did you use a consulting firm? For what purpose?

Purpose	Number of Companies
Feasibility Study	13
Plan Design	17
Pricing	12
Communication	17
Administration	6
None of the Above	2
Not applicable	1

Over one quarter of a million employees are participating in the flexible benefit programs sponsored by 23 companies. With the largest plan covering 85,000 workers and the smallest 152 workers, the median participation within this survey group is 7,000 employees.

Question 14: How many employees are currently in the program?

Number of Employees	Number of Companies Employing this Number	Total
152 to less than 5,000	9	23,652
5,000 to less than 10,000	8	61,100
10,000 to less than 15,000	2	24,000
15,000 to less than 20,000	0	0
20,000 to less than 25,000	2	43,000
25,000 to less than 30,000	0	0
30,000 to less than 35,000	0	0
35,000 to less than 40,000	0	35,000
40,000 to less than 45,000	0	0
45,000 or more	2	130,000
Total	23	316,752

Over half the companies added staff to administer the program.

Question 15a: Did you add staff to administer the program?

	Number of Companies
Yes	12
No	11

Since the amount of added staff could depend on the size of the existing benefits department, it is difficult to measure the significance of these staff increases. The additional staff required by 12 companies is detailed below with corresponding plan size noted:

Question 15b: If you added staff, how many?

Staff Members Added to Administer Program	Number of Plan Participants
1	1,800
1	8,600
1-1/2	4,500
1-1/2	2,000
2	9,600
2	45,000
2	14,000
2	85,000
2	5,000
3	4,200
5	8,900
5	10,000

Most flex programs are available to salaried and/or non-union hourly employees.

Question 16: What classes of employees are included in your program?

Class	Number of Companies
Salaried	20
Non-Union Hourly	16
Union	4
Other	1
Not applicable	1

Thirty-nine percent of the plans have a waiting period for enrollment.

Question 17: Does your plan have a waiting period for enrollment?

	Number of Companies
Yes	9
No	14

Medical, Dental, Life, Long-Term Disability, Dependent Care and 401(k) are the predominant coverages included as options.

Question 18: What coverages are included as options in your current program?

Benefit Coverage	Number of Plans Including this Benefit	Number of Different Choices allowed by Number of Plan Sponsors										
		# Choices										
		1	2	3	4	5	6	7	8	9	10	Infinite
Medical	22	4	1	6	5	2	2	0	1	0	1	
Dental	20	13	3	2	0	1	0	0	1	0	0	
Vision/Hearing	9	5	1	1	0	1	0	0	0	0	0	1
Life	17	7	1	2	2	0	4	0	1	0	0	
Dependent Life	11	5	2	2	0	0	0	0	1	0	1	
Accident	9	4	1	0	0	0	1	0	1	0	0	2
Long Term Disability	13	2	6	3	1	0	0	1	0	0	0	
Vacation	12	6	2	3	0	1	0	0	0	0	0	
Legal	8	7	0	0	0	1	0	0	0	0	0	
Dependent Care	11	10	0	0	1	0	0	0	0	0	0	
401(k)	12	10	1	0	0	0	0	1	0	0	0	
Cash	10	9	1	0	0	0	0	0	0	0	0	
Others	4											

A small minority of employers adopted modular plans in which the employee chooses among different complete plans of benefits, rather than among individual benefits.

Question 19: Is the flexible benefit plan a modular one in which the employee chooses among different complete plans of benefits, rather than among individual benefits?

	Number of Companies
Yes	3
No	20

Fifteen companies calculate the amount of benefit or flexible credits an employee will be credited under the plan according to his or her age, length of service with the firm, family status, location, sex or salary. The most popular determinant for benefit calculation was salary.

Question 20: How does the amount of benefits credited under the plan vary?

Benefit Determinant	Number of Companies Using for Benefit Calculation
Salary	8
Length of Service	5
Single vs. Family Status	6
Age	5
Sex	1
Geographic Location	1

Most companies reflected family status, followed by age, in the option prices under the flexible benefit program.

Question 21: How do the charges for any of the benefits vary?

Charge Determinant	No. of Companies Using to Calculate Charges
Age	11
Length of Service	3
Single vs. Family Status	16
Sex	2
Other: Salary	4
Not applicable	5

Most companies required new computer software to administer the flexible benefit program.

Question 22: Did you require new software to administer the program?

	Number of Companies
Yes	17
No	6

If yes, how was this software developed?

Internally	6
Internally w/outside advice	6
Purchase of System	4
Leasing of System	1
Not applicable	6

Most employers allowed employees to elect the same coverages as they had prior to implementation of flexible benefits.

Question 23: At the original implementation date, could employees elect the same coverages as they had previously?

	Number of Companies
Yes	15
No	7
Not applicable	1

Over half the respondents permitted employees to buy and/or sell vacation time.

Question 24: With respect to vacation, can employees:

	Number of Companies
Buy more	9*
Sell some	11*
Not included in plan	9

(* 6 employers allow both)

Nine of the respondents formally surveyed their employees after implementation to determine their reaction.

Question 25a: Have you surveyed your employees after implementation to determine their reaction?

	Number of Companies
Yes	9
No	14

The general reaction of surveyed employees to the program was positive.

Question 25b: If you have surveyed employees, how would you describe general reaction to the program?

Very pleased	7*
Pleased	5*
Neutral	0
Displeased	0
Not Applicable	11

(* 3 employers conducted informal surveys)

Only five respondents provided average per-person costs for the program:

Question 26: What is the average per-person cost to the company for the program?

- $75/per person for one-time systems and communication
- approximately 35 percent of the compensation level (5,000 in plan)
- $70 single, $120 family (152 in plan)
- $180/month/person (2,000 in plan)
- $827/person (8,600 in plan)

Fifty-two percent of the respondents have done studies to measure the effect of the program on the organization's benefits costs.

Question 27a: Have you done any studies to measure the effect of the program on the organization's benefit costs?

	Number of Companies
Yes	12
No	9
Not Applicable	2

Of these 12 companies, seven companies' costs were reduced, three increased and two did not know.

Question 27b: If yes, has the flexible program reduced or increased your company's benefit costs?

	Number of Companies
Reduced	7
Increased	3
Neither	0
Don't know	2
Not applicable	11

The outcome of the program mentioned most frequently by these flexible benefit plan sponsors is cost reduction/cost management.

Question 28: What is the most important outcome of the program?

Outcome	Number of Companies*
Cost reduction/cost management	11
Tax effectiveness	3
Employee awareness	3
Employee relations	4
Employee satisfaction	3
Employee attitude	2
Employee acceptance	1
Employee cost sharing	1

* Some respondents cited multiple outcomes

More than half the respondents have made changes since initial implementation. Of those sponsors changing their flexible benefit programs, all added complexity to their program.

Question 29: How has the program changed since you implemented it (if at all)?

	Number of Companies
More complex	8
Same	13
Less complex	0
Not applicable	2

If companies were starting up their programs today, knowing what they know now, 39 percent would communicate the program more extensively and another 35 percent would do nothing differently.

Question 30: If you were starting up a flexible benefit program today, knowing what you know now, what would you do differently?

	Number of Companies
Run a pilot program	1
Include fewer choices	1
Allow more time for design	2
Communicate more extensively	9
Nothing	8
Other (See below)	4
Not applicable	1
Other:	
Include more choice	1
Know IRS rulings	1
Price plan options further apart	1
Take out pension and life insurance options	1
Use Jan. 1 plan year date	1

FLEXIBLE SPENDING ACCOUNTS

Sixty-nine percent of the respondents have a Flexible Spending Account.

Question 31: Do you have a Flexible Spending Account?

	Number of Companies
Yes	16
No	7

Most Flexible Spending Account plans became effective in 1984.

Question 32: When did your Flexible Spending Account become effective?

Year Plan Became Effective	Number of Companies
1981	2
1982	0
1983	3
1984	10
To be effective 1/85	1

The source of the Flexible Spending Account contributions is primarily salary reduction only, or a combination of salary reduction and company money.

Question 33: What is the source of the contributions?

Contribution Source	Number of Companies
Company, only	2
Salary reduction, only	6
Both of the above	7
Other (See below)	1

Other: Contributions are from excess credits and vacation (this employer also allows contributions from salary reduction and company).

Medical, Dental, Vision and Dependent Care expenses are predominantly covered under the Flexible Spending Accounts. Legal care is covered by 25 percent of the respondents with Flexible Spending Accounts.

Question 34: What expenses are covered under your Flexible Spending Account?

Expenses Covered	Number of Companies
Medical	16
Dental	15
Vision	14
Dependent Care	11
Legal	6
Auto	1
Other: All that is IRS deductible	1
Adoption expenses	1
Financial planning	1

Question 35: What is the status of your program?

Status	Number of Companies
On hold	2
Running as usual	12
Terminated	0
Modified	2

At the time of the survey, most companies anticipated moderate or no changes to their programs as a result of the proposed regulations.

Question 36: Will the effect of the proposed regulations require:

Degree of Change	Number of Companies
Substantial revision of your program	4
Moderate change in the program	8
No change	4

PART 2 — LIST OF PARTICIPATING COMPANIES

ARMCO, Inc.
American Mutual Life
Carpenter Technology Corp.
E-Systems
Eastman Kodak
First Bank System, Inc.
Fluor Corporation
Girard Bank
LTV Corporation
Loews Corporation
Morgan Guaranty Trust Company
Morgan Stanley & Co., Inc.
Northern States Power
Northern Telecom
PepsiCo
Ponderosa, Inc.
Princeton University
Public Service Electric & Gas Co.
Sovran Bank
St Paul Cos.
St. Vincent's Hospital
TRW, Incorporated
Union Planters National Bank of Memphis

Chairman PICKLE. We are to skip over Mr. Kaye, is that correct, and go to Manuel Castells, a partner in Kwasha Lipton.

Proceed, please.

STATEMENT OF MANUEL CASTELLS, PARTNER, KWASHA LIPTON

Mr. CASTELLS. I am an actuary and a partner at Kwasha Lipton, an independent employee benefits consulting firm that serves the business needs of large corporations.

I am pleased to be here to testify on behalf of my firm.

In the 40 years that we have worked in this field, we have helped our clients develop and improve programs that were designed with one purpose in mind—improving the productivity, working conditions, and general welfare of their work force.

Years ago employers realized that issues beyond pay affect their employees and thus their own existence. In recent years, as quality of life has become a major concern, the emphasis on the non-pay aspects of work has increased, and with it employers' emphasis on variety, flexibility, and choice in benefits has increased.

In the seventies, concern with equity and benefits brought about significant legislation in the pension field, ERISA. ERISA, for our clients, represented a minor change in terms of the way they were providing benefits, but it represented a significant price in higher administration and in paperwork, but the overall perception among our clients is that this legislation was needed to control the abuse that existed, and that while ERISA caused a shakeout with significant plan terminations, that those plan terminations were plans that probably should not have existed to begin with.

While in the seventies the focus was on correcting perceived abuses of the system, the focus in the eighties seems to be on revenue issues. There can be no question that employee benefits are significant with regard to revenue. In the 1970's, the benefits issues were looked at too narrowly with the result that the many paid for the excess of the few. We feel the same could occur now if changes are made without looking at the broader social issues.

Accordingly, we feel that Government can, by overregulation and taxation, hurt our private pension system and that some years down the road this will greatly increase the burden that the Government will face in caring for the welfare of its people.

Within that context, my written testimony addresses your specific concerns.

I would just like to move to the items which I feel ought to be emphasized from this written testimony.

Changes in the working population, indeed, in American society as a whole, have made flexibility one of the most important considerations in the design of benefit programs.

In this regard we would encourage a further move in the direction of tax deductibility of employee contributions to benefit programs.

In the retirement area, we favor extending to defined benefit plans the tax advantaged status currently available to employee contributions in defined contribution plans under section 401(k).

In the flexible benefit area, we feel that the compromise reached in the Deficit Reduction Act was the worst possible one. Flexible spending accounts were being used quite effectively by employers in instituting high deductible and high coinsurance plans. This approach, which was effectively eliminated by the Deficit Reduction Act, represented the best method available to the private sector in controlling health care costs.

Those are the two items that we particularly wanted to address at this point. This concludes my oral testimony.

Chairman STARK. Thank you. We can get back to exchanges here when we finish the panel. I appreciate that.

[The prepared statement follows:]

STATEMENT OF MANUEL CASTELLS, PARTNER, KWASHA LIPTON

Honorable Chairman and Members of the Subcommittees: My name is Manuel Castells and I am a Partner in Kwasha Lipton.

I am pleased to be able to appear before you to testify on behalf of our firm. Kwasha Lipton is an independent employee benefit consulting firm located in Fort Lee, New Jersey. We serve the business needs of some 400 American companies, primarily large corporations. About one third of our clients are Fortune 500 Industrial and Service companies.

During the 40 years that we have worked in this field, we have helped our clients develop and improve programs that were designed with one purpose in mind: improving the productivity, working conditions, and general welfare of their work force. Years ago, employers realized that issues beyond pay affect their employees and thus their own existence. In recent years, as quality of life has become a major concern, the emphasis on the non-pay aspects of work has increased. And with it, employers' emphasis on variety, flexibility, and choice in benefits has increased.

As a result, our clients have been and continue to be interested in creative means of enhancing the quality of life for their workers—to keep the workers' loyalty and to increase productivity and competitiveness. When the Government decided to expand the regulation of benefits in the 1970s, our clients and other large companies were, by and large, already doing what the Government was soon to require. Then as now, much of the legislation was aimed at the minority that abused, and in some cases badly abused, the system.

Our clients paid a significant price in higher administrative and paperwork costs in complying with ERISA. Nonetheless, the overall perception among our clients is that this legislation was needed to control the abuses that existed and that, while ERISA caused a shakeout with significant plan terminations occurring in 1976, they were plans that probably should not have existed to begin with.

While the 1970s focussed on correcting perceived abuses of the system, the focus in the 1980s seems to be on revenue issues. There can be no question that employee benefits are significant in regard to revenue. In the 1970s the benefits issues were looked at too narrowly, with the result that the many paid for the excesses of the few; we feel the same could occur now if changes are made without looking at the broader social issues and without some sort of national benefit policy being formulated. We stand in the position of once again penalizing those who are doing the most to aid social welfare in the most efficient way—the private sector.

Accordingly, we feel the government can by overregulation and taxation kill our private pension system and that some years down the road—especially when the baby-boom generation now in their 20s and 30s reaches retirement—this will greatly increase the burden the government will face in caring for the welfare of its people.

Within the context, we are delighted to address your specific concerns.

1. PREVALENCE OF FRINGE BENEFITS

In discussing benefits it is important to distinguish exactly where benefit dollars are going. In its most recent report on Employee Benefits, the Chamber of Commerce reported that the employer's portion of employee benefits averaged 36.7% of payroll in 1982. The largest portion of this, 22.1%, went for legally required payments, paid time off and other taxable amounts.

Paid time off—lunch and rest periods, vacations, holidays, sick leave, etc.—amounted to 11.9% of payroll. These payments are deductible by the employer and taxable to the employee for income and Social Security tax purposes. Legally required payments—Social Security, Medicare, Workers' and Unemployment Compensation, and other payments imposed on employers by law—constituted 9.5% of payroll. These payments are deductible by employers and are generally tax exempt for the vast majority of employees.

The remaining 14.6% represent either tax-exempt or tax-deferred benefits that the employer has a choice about and that are deductible by the employer. Of this, 6.5% went for pensions with taxes deferred until receipt by employees. And 6.6% went for life and medical benefits that are generally tax-exempt. It is on this 14.6% of payroll that I will focus my attention and the balance of my testimony will deal with these discretionary, tax-exempt or tax-deferred benefits.

In looking at the 14.6% costs figure, it is revealing to look at which employees those benfits cover. A recent study by the Employee Benefit Research Institute reveals that over 47 million of the more than 80 million nonagricultural workers in the United States are covered by retirement plans. This represents 59% coverage, including 37% of workers earning less than $10,000 a year, over 57% of workers earning between $10,000 and $15,000 and almost 72% of those earning between $15,000 and $20,000 a year.

Coverage for group health benefits is even greater. Almost 50% of the 15 million workers earning $5,000 to $10,000 are covered by group health benefits where they work. Over two thirds of the nearly 18 million workers earning $10,000 to $15,000 are covered, while coverage for those in the higher wage brackets ranges from 80% to nearly full coverage.

In both cases, benefits are voluntarily provided by employers. If these benefits were not provided, the Government's social welfare system would face a greater burden for health benefits and the pressures on the social security system would greatly increase. This would be especially true for those workers in the lower wage categories who are less likely to have other resources to draw upon.

As to future increases in benefit levels, the period since the statistics were compiled has seen an expansion in the number of savings/thrift plans that include a 401(k) feature and this trend is likely to continue. The 401(k) feature permits workers to save for retirement on a tax-deferred basis. Plans with this feature have become increasingly popular with both employers and employees in recent years. For employers, they provide "more bang for the benefit buck," lower costs and less administrative red tape. For employees, they provide a measure of portability and greater control over investment.

Since employees (according to surveys) have greater faith in the private pension system than they do in the Social Security system, employees also feel that these plans give them greater control over their own retirement destiny. Employers find that employees understand and appreciate their benefits more when the dollar amounts involved are easily discernible and their sense of control greater. The expansion of the use of the 401(k) feature will increase the amount spent in the tax-deferred benefit area. This will not, however, have a significant impact on Social Security since the employee contributions to such plans are subject to Social Security taxes.

2. BENEFITS BY SALARY RANGE

My previous comments have already addressed this area, but I want to discuss the integration of plans with Social Security and the effect this has on benefits received by various salary levels. Integration refers to the coordination of pension benefits with Social Security. Since both these sources of retirement income are provided for, at least in part, by the employer, it is reasonable to take them as a unit when defining retirement income objectives. Integration produces the following beneficial results:

(a) The level of retirement income (excluding personal savings) can be accurately planned by the employer.

(b) The tilt in the Social Security benefit towards the low paid can be compensated for so that the employer provides equitable retirement supplementation at all pay levels.

From a tax standpoint, the benefits received by a worker at the lower end of the wage scale will be heavily weighted towards Social Security, which will generally be completely tax exempt. For workers at the very upper end of the scale, the benefits will be heavily weighted towards company pension, which is fully taxable. Further, half of the Social Security benefit is subject to tax as well.

3. EMPLOYER STRUCTURE OF FRINGE BENEFITS AND THE IMPACT OF TAX STATUS

I want to address my discussion in this area to our experience with our clients, who work in a broad variety of industries and services. I think the kinds of processes we see them go through can help you understand what really motivates employers in determining the kinds of benefits and compensation they offer to their employees and how they structure those benefits.

Most of our clients are motivated by their employees' needs, by a strong desire to be fair, and lastly almost as an afterthought, by tax effects. In their benefit programs, they work to assure equity in the various segments of their work force and equity for their workers in comparison with those outside the company. Looking outside, they are motivated to keep their workers' competitive with others in their industry or service. They seek to keep benefits equitable within their community or region.

Internally, there are various equity issues: Keeping salaried workers' benefits equitable with hourly workers, keeping workers' benefits equitable among various divisions or subsidiaries (including international operations in many cases), and keeping benefits equitable and nondiscriminatory across various salary levels, occupations, and professions in the organization.

In recent years, we have seen greater employer concern for equity issues of a different sort. Employers have recognized that their work force has changed from predominantly one wage-earner families to a much broader group of single workers, one-parent families, and dual wage-earner families. This has led them to look at equity issues across these groups within their work forces as well.

They are also concerned about the needs of their work force. Once an employer perceives a need—something that will improve workers' productivity, loyalty, and promote their general welfare—they take steps to explore the feasibility of trying to meet that need. Depending on their corporate culture, their place in the community and other factors, some companies are very benevolent or even paternalistic in providing various benefits for their work force. This can be most pronounced when a company is a leader in its field or dominant in its communities. And executives are not unaware of the ripple effects their benefits decision making can have on others outside the company in terms of general social welfare.

Lastly, our clients look at tax effects or considerations for the benefits they provide. They do this almost as an afterthought. To refer again to the Chamber of Commerce's 1982 Study, over 12% or one-third of the benefit dollars went for voluntary, fully taxable, benefits that employers provided to employees. Moreover, since tax qualification is an increasing necessity for all kinds of plans, they look at tax issues to meet the necessary government regulatory requirements.

For employers, tax considerations are most important, however, when they affect employee participation in and acceptance of various benefits. And for a variety of reasons, not the least of which are the higher effective tax rates, employees are much more tax conscious and tax wise than they have been in previous years. I think this is easy to understand when you realize that from an employer's perspective, benefit costs are generally tax deductible. Lack of effective tax treatment can mean, however, that an employer will not be able to offer a benefit, because equity cannot be maintained. That is, the benefit may be discriminatory in its actual effect, rather than its structure. And this can mean that employers may avoid giving those benefits to any employees because a few, and not necessarily just lower paids, will not participate.

4. ECONOMIC EFFECTS OF UTILIZATION OF BENEFITS

There can be no question that employer payrolled health care has had an effect on the level of usage and costs in the U.S. This coverage is virtually tax-exempt for the employee and, until relatively recently, employers paid virtually 100% of these costs. Access to such coverage was a very high priority in collective bargaining and an important issue for others as well. This can be illustrated by referring to the statistics I cited earlier to note that medical coverage has the highest saturation for all benefits.

Employers are already moving to cut costs in this area. And high health care costs are increasingly a societal concern of a much broader nature. However, these tax exempt benefits do not seem large enough—looked at on an individual basis—to generate a significant amount of revenue. Moreover, I submit that taxing these benefits might have a highly undesirable effect: Higher-paid employees will continue their coverage regardless; however, lower-paid employees might choose to drop their coverage and they are the ones most likely to fall back on Government. I think that very careful analysis must be done before such a change is contemplated. Here especially, short-term revenue gain may lead to long-term revenue loss.

It would be ironic if government, which has increasingly looked to the employers to increase their role in health care for the elderly by shifting more of Medicare's burden to them, would now contemplate a shift that might move more of the working population onto Medicaid as a health carrier of first resort.

In the concluding section of my presentation I will discuss this area further.

5. EFFECT ON FICA TAX BASE

First, let me say that we are extremely pleased that you are interested in ways to lower the FICA tax rates. So far, the history of the FICA rates has been one of increases rather than reductions.

As mentioned above, of the 36.7% of payroll costs going for benefits, 14.6% are tax deferred or exempt and thus are not included in the Social Security wage base. (Also excluded from the wage base are the various legally required payments—mostly Social Security taxes themselves. But I don't think anyone is seriously suggesting taxing the value of Social Security taxes—this would be a tax on a tax.) Congress recently changed the law relating to 401(k) contributions to include them in the FICA wage base. The benefits currently excluded from FICA taxation are not that significant in terms of total payroll. Including these benefits in the FICA tax base will generate corresponding increases in the benefit levels since overall covered wages (including the imputed value of such benefits) will rise as result. And if such a move has a deleterious effect on private provision of these benefits, especially among the lower paid, then the burdens and pressures on Social Security and other federally funded social programs will increase.

6. EFFECT OF A FIXED DOLLAR CAP

I think the negative effect from a fixed-dollar or percent-of-compensation cap would be far greater than the simple revenue implications could lead you to suspect. As I noted in No. 3, equity considerations play a primary role in motivating our clients' benefit decision making. And it is in the area of equity that a fixed dollar cap would create serious problems.

Such a cap would lead to equity problems for all aspects of employee populations. It would mean that the actual benefits that employees in low cost of living areas receive would be substantially higher than those in high cost of living areas. The following table shows the approximate cost relationship for a typical health benefit program for different age, sex, family status and region:

Category versus Category	*Cost ratio*
Individual, 55-64/Male, 20's	4-to-1.
Family/Individual	2½-to-1.
Southern California/North Carolina	2-to-1.

As you can see, a cap would much more heavily affect permissible benefit levels at older companies in high cost areas. In short, it would create enormous difficulties across the very groups, regions, and individuals that employers have been taking such pains to treat equitably.

7. RELATIONSHIP BETWEEN EMPLOYER PROVIDED AND GOVERNMENT PROVIDED PROGRAMS

While this is the last question addressed in this hearing, I think it is really first and foremost in significance. Since the Great Depression, this country has been committed to providing some minimum levels for the social and economic welfare for all its citizens. Since that time, government has played a significant role in providing what has recently been characterized as the "safety net". But so, likewise, has the private sector played a role in providing this system of social welfare.

Where a government system is in place, employers have worked to support and supplement it. Most employers have integrated their pension plans with Social Security as we noted earlier. Some employers have provided benefits to retirees which coordinate with Medicare. And apparently, employers have not done a bad job. As I noted earlier, workers have greater faith that they will receive an employer-sponsored pension than they do that they will receive Social Security.

If we are to look at benefits as a revenue source, perhaps it is instructive to inquire where the revenue will go. The answer is that it will go in large part for these very programs: Social Security, Medicare, and Medicaid.

But let's look at a specific situation. Employer-sponsored health care for retirees is largely a benevolent act, rewarding employees for their service. The costs for these benefits have risen and will continue to rise drastically. Congress has recently increased employers' burdens in this area by making self-funding more difficult and by making employers the carrier of first resort instead of Medicare for those active beyond age 65. Since employers maintain these benefits on an entirely voluntary basis, what will the effect be if they simply decide its too much trouble and too costly to provide these benefits any more? Can there be any questions that Medicare would face problems of a magnitude that would dwarf its already large problems?

Recently, the emphasis in our society has turned toward the individual providing more for himself or herself and individuals have been seeking greater power and choice over their benefits. Employers have responded to these needs. Savings/thrift plans were already growing before 401(k) came along and accelerated the trend. As noted before, these plans have proven very popular with employees because they provide a measure of portability and greater individual control and choice.

Employers embraced the flexible benefits concept as a way to help control costs by letting employees choose and use only those benefits they really needed. Flexible spending accounts looked particularly attractive in this regard, because they let employees select the benefits they really needed and rewarded them for not using benefits they didn't need by paying them taxable compensation at year's end. Flexible spending accounts held great promise for helping control the vast spiral in health care costs.

All that ended with IRS and Congress action in essentially eliminating flexible spending accounts entirely. We remain shocked at this section, because it seems so contrary to other Congressional actions encouraging individuals to look after their own needs and interests.

Both 401(k) and flexible spending accounts went against the grain on nondeductibility for employee contributions. In the U.S., employer contributions have generally always been tax-deductible. But U.S. workers alone in the industrialized world are unable to deduct their employee contributions to benefit programs. With flexible spending accounts effectively eliminated, employees are now able to deduct only 401(k) and Individual Retirement Account (IRA) contributions.

If Congress wishes to look at placing greater tax burdens on employers by eliminating deductibility for some benefit costs, we urge you to look at permitting greater deductibility for employee contributions. This would encourage employees to look after their own retirement and benefit needs and be consistent with recent trends in this direction. And if the success of 401(k) is any indication, such a move would be not only equitable but well received by employees.

For in the final analysis, it is the private sector which has been and will continue to be best able to provide benefits on an equitable, flexible, efficient, and more cost-effective basis. Directly funded public programs are inefficient and contain no cost containment incentives. It is to support public programs that we are seeking this revenue to begin with. It makes little sense to take steps which can ultimately increase the burdens for already strained public programs. Let us continue providing these programs through preferred tax treatment for employers, employees, or both.

This concludes my testimony. On behalf of myself and my firm, I wish to thank the Members of the Subcommittee for giving us this opportunity to present our views on these important issues. I will be happy to try to answer any questions you may have.

Chairman Stark. We have next Mr. Rex Adams, vice president, Employee Relations, Mobil Oil Corporation.

We have finished this panel. Have I left anybody out here?

Just a couple of ideas that I would like you to comment on. I don't think that anybody doubts that the numbers that concern Chairman Pickle and that he has brought here. We have an increasing percentage of compensation coming in the form of fringe benefits. Mr. Cohen, my good and dear friend from the U.S. Chamber of Commerce, he has been looking at the Laffer curve too long. He couldn't see a curve if he wanted to because he has been brainwashed by the supply side people.

But time will tell. At any rate, it is increasing and we are losing some revenue, whether it is Social Security, or the Treasury, or general revenues.

I think that Ms. Koralik's testimony is well received. There is some incentive. The life insurance salesman will make that as his great argument. It may not be the best investment in the world, he or she will say, but unless we force you to sign up for this policy, you won't save, so that is an assumption that many of us accept.

I don't know as we have every proof of that one way or the other, but the exemption for low income people might solve some of that.

I tend to think this, and this is the idea that I would like you to comment on:

I think nobody denies the socially desirable end of providing medical care and retirement benefits. I think, however, that that should not rest entirely on the tax system.

If we, for instance, went to the VAT tax, which, if Secretary Regan ever tells us what he has got in mind over there, they might propose, this would all be moot because we could collect it right off the top. I think, as they have in France and England and Germany, according to my studies, we could adjust.

There is this one big hullabaloo but then everybody pays their 18 percent on services and goods, it is forgotten, and it is never raised again.

It is kind of like a devaluation. It is a glitch in the economy and it goes on, so I guess what I am saying is that it is more likely that we could solve your problems of getting employees—employers will probably do it anyway out of the goodness of their heart, and there is no tax differential to them, so if we were to tax—you are shaking your head. We will come back to that.

What I am suggesting is that the employer gets to deduct it either way as an expense, so there is no tax incentive necessarily to him.

Mr. Beadle. That is right.

Chairman Stark. We could increase our revenue, eliminate the problem with the very lowest paid, and find other ways, legislatively perhaps, to encourage either providing, as Kennedy attempted to do some time ago in the Corman-Kennedy bill, an alternate federal insurance, if the employer cannot provide insurance, so there are other ways to deal with that. So my feeling is that your concerns have more than one solution, that is, the Tax Code is not the only thing that gets employees to sign up.

Certainly in medical insurance I would think. I would think they would want that regardless of the tax consequences, and it is not as big a lever on the employer to do what he has to do.

Therefore, I would tilt against this panel and say that we perhaps ought to do something to extract a total charge, perhaps an excise tax or some form of tax on these fringe benefits prospectively, let's say, if they increase above some standard level.

Mr. Beadle. I think there are two or three points here. First, on the value added tax that is prevalent in some European countries one has to remember that those countries have virtually totally nationalized their health benefits, pension schemes and so on, and they are a very costly drain on those countries.

Chairman Stark. I know that.

Mr. Beadle. And influence the whole attitude towards the free enterprise system. There is a cradle-to-the-grave system that has influence the thinking of the people. I don't think you can ignore the implications for the income security area in this country when considering a VAT tax in this country. I think that is one of the issues that needs to be looked at very carefully.

You commented on rising costs. One of the things I find that has been handled a bit simplistically in these examinations has been what is causing the rising costs.

If we were talking 3 or 4 or 5 years ago, maybe 5 years ago, the economy was rolling at that time, demands were high, there was a kind of a runaway demand for benefits. That has stopped. It may even be gone forever.

I wouldn't want to go that far, but it has stopped. It hasn't stopped rising costs because health care costs are rising and they would have risen under government or private plans. There is a lot of activity now going on to bring those under control. I don't expect the same rate of increase to prevail in the next 2 or 3 years that we have seen in the last 2 or 3 years because forces were at work to bring it under control.

You were talking about the UAW earlier this morning. One of the things in which both the industry and the UAW agree is that they must work together to bring health care costs under control.

Chairman **Stark**. I tend to call it medical care.

Mr. **Beadle**. I beg your pardon?

Chairman **Stark**. I think somebody is overlooking the changing age factor in our population in things like long term.

Mr. **Beadle**. Absolutely.

Chairman **Stark**. Which I perceive going out of sight. That may not be covered by employee medical benefit plans, but I really don't see under our present system anything but tremendously increasing medical costs.

Mr. **Beadle**. What we are really saying is that the premiums that need to be shouldered without tax benefits by employees would become more than they could afford. If the cost is going to be there, if it is a cost related to aging, and it is a cost related to the genuine under control cost of delivering health services, the costs will be there and will need to be absorbed by someone.

Finally on the subject of tax, tax incentives shouldn't do it alone. I think that is absolutely right, but I don't think it is doing it alone. Employers have undertaken quite a responsibility in this country. There is an administrative responsibility, a communications responsibility, in some cases even a liability responsibility.

We have certainly seen that once benefits are installed, employers tend to have to pick up a lot of the costs of increases, and they have taken that on their shoulder.

Without the tax incentive, I doubt that they would want to engage in the sort of massive encouragement of employees to participate, that would be necessary.

Chairman **Stark**. The only thing that occurs to me, and you may know the figures, is what would you guess is the percentage of employees in this country who are not covered by benefit plans such as the type you would advise for your clients; that is, pension and company-sponsored and supported medical benefit plans? Half?

Mr. **Kaye**. Less than half.

Mr. **Beadle**. About 150 million employees and their families are covered under such plans, so we are talking about the rest having something less than full coverage.

Chairman STARK. Can you quantify that?

Mr. KAYE. I would estimate that in the area of retirement plans, if you took employees who were over age 25, that probably at least two-thirds of the work force is covered under an employer-sponsored retirement plan.

Chairman STARK. What I am trying to get at is, how many.

Mr. KAYE. The figures are much higher for——

Chairman STARK. How many people are self-employed, employed casually, employed in domestic service?

Mr. BEADLE. Roughly a third.

Chairman STARK. About a third?

Mr. CASTELLS. Health care coverage extends to about 80 percent of the working population.

Chairman STARK. Commercial health care, medical care plans?

Mr. CASTELLS. Yes, so you are talking about 20 percent of the population is not covered under employer-provided health care benefits. Obviously a few of those do have some other benefits, but you wouldn't think very many, so that is probably the core of the uncovered working.

Mr. BEADLE. Have you included in your figure those who would be covered by definition under Medicaid or Medicare?

Mr. CASTELLS. No, just the working population.

Mr. BEADLE. That is another group that is covered.

Mr. CASTELLS. The elderly and unemployed that would be covered under Medicaid.

Ms. KORALIK. I would like to comment on another question that has been raised. You seem to be suggesting that benefits just keep going up, and I think what Carson was suggesting is that the cost of benefits keeps going up, but the benefits that are being provided is not necessarily continuing to expand.

We did a survey recently of 1,200 of the large corporations that you were referring to earlier that do provide good benefits. What we have been seeing is a definite trend to decrease the level of benefits that is being provided in the health care area.

Just to give you one example, in the area of what do you provide to somebody who is hospitalized. In 1982, 67 percent of these companies provided 100 percent of the cost of a semi-private room for the full length of stay in the hospital.

By 1984 that 67 percent had dropped down to 42 percent. So we are seeing a definite trend downward.

We are seeing similar trends in the level of benefits provided for surgical expenses. The deductibles are increasing. They are providing incentives for people to have surgery done on an out-patient basis, and to get second opinions before having surgery done at all. So I think employers are trying to do quite a bit.

Another question that you had asked earlier was, have cafeteria plans done anything to control health care costs. Someone on an earlier panel said that there wasn't any quantitative information, but there is quantitative information now. It is, I guess, what the Treasury Department would call anecdotal information. It is a fairly small group of companies, but I think some of the larger companies like PepsiCo and American Can do have very clear information that their divisions that have flexible programs in place are experiencing a much lower rate of cost increase for health care than their divisions without the flexible programs.

So I think the cafeteria plans have been shown, in selected situations at least, to be successful.

Chairman **STARK**. Isn't that really saying that if you make a decision based on cost and preference, they will be a little selective?

Ms. **KORALIK**. Yes.

Mr. **BEADLE**. Precisely.

Chairman **STARK**. Whereas, if you just sign the employees' sheet when you check in and get your time card and you are told this is your life insurance, there is your disability insurance and this is your health plan, you don't make any choice, so obviously some people, given some preferential choosing in the ability to price, will purchase those things which they perceive as being more beneficial to them, and that may save them a good bit.

That is to be expected. The problem is that they may just all overlook disability insurance, because they don't think that is very likely. Our question is, how to quantify the benefits of this reduction of the tax base for the foregoing Federal revenue, what are we getting for that, and is it growing, and ought that to be accounted for in some other way? Ought we appropriate it and authorize it? Those are the issues.

I don't think any of us would quarrel that it is great to have medical plans and good retirement income and encourage thrift and all those things. There are some who would say that we ought not to do it with the Tax Code. I doubt if that will ever be an empirical decision.

Mr. **BEADLE**. Congressman Stark, your committee may find it useful to look, at the table on page 196 of our questionnaire.

We asked how the CEO's viewed the expansion of benefits, 15 different benefits between now and 1990, if tax preferences were unchanged, and again if they were changed, and the statistics make very interesting reading.

Briefly, if tax preferences aren't changed, by far the bulk of the CEO's believe benefits will stay essentially the same, except for health benefits which they expect—which more believe will be decreased than those who believe it will be increased.

That is sort of a sign of the times, but it does indicate a significant slowdown in the pace of additional benefits, as Susan described them without tax change.

Chairman **STARK**. If taxes are levied.

Mr. **BEADLE**. No, if things are continued as they are. There will be a greater holding of the line of reduction, you might say, if there are taxes, and then it starts to move into the social policy area, whether it goes too far——

Mr. **CASTELLS**. Mr. Stark, I think when you start looking at these statistics that show ever increasing dollars being spent in the benefits area, that you have to be careful to separate the reasons for each of the increases, and you start off with inflation generally.

Then you add on to that the fact that inflation on medical care is significantly higher, and that in and of itself might explain the increase in the dollars spent.

You also have, of course, the increase in the 80 percent or so that is covered that has occurred over the last few years, and those of us in this field wonder whether, if you eliminated all of those, and you then only addressed the people that had reasonable programs right now, whether or not those programs are in fact expanding as a whole.

There is a lot of statistics that would seem to indicate that those programs, at least in the medical care area, are not expanding because of the significant concerns with this extremely high level of inflation in medical care.

Most employers of any size are very concerned about this and are taking significant action both on their own directly, prodding the medical establishment, and in the design of their benefit programs to control medical care costs.

Chairman **Stark**. They suddenly realize that they have got a fixed cost there and it is really not related very much to productivity, if you think about it.

Mr. **Castells**. That is right.

Chairman **Stark**. It has more to do with the age of the work force and a whole host of things.

Mr. **Castells**. On the other hand, they do want to provide the benefits that are needed to maintain the quality of life, and one of the ways that they were doing this is through these flexible spending accounts where they were able to allow people to set aside money in a tax sheltered environment, and then if an emergency were to arise during the year, so that an expenditure was really necessary—because now the moneys are actually moneys that the employees had control of themselves—then the money would be there to take care of that emergency.

It is a very effective cost control mechanism that is gone as the result of recent legislation, which I think was unfounded, just unreasonable.

Chairman **Stark**. I want to thank the panel very much.

Mr. **Beadle**. Thank you.

Chairman **Stark**. The next panel is a panel of employers. Rex Adams, vice president, Employee Relations, Mobil Oil Corp.; Howard Weizmann, manager, Benefits Planning and Design, Sun Oil Corp., and Robert Winters, vice president, Prudential Insurance Co. I am reading the letter that has been sent. I hope you understand it better than I do.

I would ask if you would like your testimony in response to this very succinct letter be made part of the record in full. I gather you were requested in a microsense to bring us information about your own companies. I guess you have heard enough of the testimony to know our interests in terms of in this case what will happen.

I expect what we are seeking from you is how would you change your strategies and how would your employees' benefits change?

You might want to speak to that, but otherwise proceed in any manner you wish.

Mr. Adams, you are first on the list.

STATEMENT OF ROBERT B. PETERS, CORPORATE COMPENSATION AND BENEFIT MANAGER, MOBIL OIL CORP.

Mr. **Peters**. Mr. Chairman, my name is Robert B. Peters, manager, corporate compensation and benefits, Mobil Oil Corp. I apologize for Mr. Adams' inability to be here today. An unexpected business commitment came up which prevented him from appearing.

I am very pleased though on behalf of Mr. Adams to take this opportunity to discuss the development of benefit plans within Mobil over the past several years, and also the outlook for those plans, should Congress decide to amend the tax treatment of them, if agreeable to you.

We at Mobil have been in the employee benefit business for quite a long time, the entire 20th century, as a matter of fact. Our first formal pension plan was established in 1903.

Also, our wholly owned subsidiary, Montgomery Ward, established the first group health life and accident insurance program in this great country back in 1910.

As a result of this early start in the employee benefit area, our current employees have all participated for their entire careers in the favorable tax treatment of benefit plans which your subcommittees are reviewing.

We have submitted answers to your questions and I will touch specifically on them in a minute. Our employees today, however, assume that their retirement, medical and other benefits, are truly an integral part of their total compensation package.

As a matter of fact, many of them only came to work for our company because of the security those programs offered.

I don't think many, if any, of them look on these benefits in any way as tax loopholes. To date we feel there has been considerable harmony both in the public and private sector. The current systems of benefits in this country represent a harmonious mix of both public and private programs to cover the benefit needs of American workers.

We believe it would be unfortunate if the favorable tax treatment of four decades which has produced the private side of this mix should be changed by Congress. We are concerned about the security which our employees and their dependents enjoy under our present benefits system. We believe that changing the tax treatment could, I repeat, could do permanent and irreparable damage to that system.

I would emphasize that if there are detrimental changes in the tax treatment of benefit plans, there will be, without a doubt, changes in our private benefit package. There is already a change in management's attitude toward private benefit plans because the members of top management themselves in a great number of companies are restricted by the section 415 limits in the benefits that they can receive from a qualified defined benefit or defined contribution plan.

They are becoming part of a very large, growing group that are no longer protected by the full security of funded benefits.

If the favorable tax treatment is further reduced, or the section 415 limit continues frozen, attitudes toward the private benefit system will be more adverse or at least will show some signs of lack of enthusiasm.

One number that is not in the paper we submitted that I would like to bring forth for the record deals with the deductible cost of our plans and the taxable benefits received from them.

The benefit programs of Mobil Oil, which I have been discussing, cost our company in 1983 approximately $263 million and that amount was tax deductible to the corporation.

On the other hand, those same benefit programs in 1983 generated in excess of $350 million in taxable benefits to employees and our retired employees.

Finally, I believe your letter has asked a bit about our philosophy and you did orally at the beginning, as we develop our total compensation package. In response, I would say that we focus fundamentally on the need of our employees. We obviously have to be concerned about our ability to finance those programs, and certainly we keep a very watchful eye on the competitive trends in our industry.

We provide first for wages or salaries. That is the prime desire of all employees. We think of their medical disability and life insurance needs after that, while they are active and indeed, while they are also retired.

Of course, the primary concern to us and to your subcommittee is the fact that we provide retirement income when employees are no longer able to be gainfully employed.

Most of our employees do not have the knowledge or the technical resources to arrange for these programs themselves. We think we must continue to play an important role in this area and we would suggest strongly that we make progress in this review slowly and weigh the possible consequences of each of the changes, if there are in fact changes to be made.

Specifically, the eight questions, Mr. Chairman, that you raised in your letter of August 30. The first question asks what is the cost of benefits provided to employees?

Well, the total cost for tax-free or tax-deferred benefit plans at Mobil Oil Corp. was $263 million in 1983.

Attachment A to the paper we have submitted sets forth on a plan-by-plan basis details of our program, and also shows the 10 year earlier set of costs for comparison purposes.

Question 2 asks what percentage of total compensation does the total cost of benefits represent. Our 1983 costs represented 17.6 percent of total payroll. Again, this is spelled out in detail on attachment A.

The cost of tax-free or tax-deferred benefits provided to our employees is that $263 million previously mentioned.

Question 4 asks what percentage of total compensation and total cost of benefits does the cost of tax-free or tax-deferred benefits represent.

As I stated earlier, all of the benefits in attachment A to our paper are either tax-deferred or tax-free. We estimate, on the other hand, that the cost of benefits which are fully taxable, for example, payment for time not worked, amounts to an additional 10 percent of total compensation.

Question 5, what is the per employee cost of both the total benefits provided and each type of benefit? The cost per employee for Mobil Oil Corp. employees in 1983 was just slightly over $8,000 per employee. Again this is broken down by each of the programs in the attachment.

Question 6, what percentage of the employee's salary does the cost of the benefits provided represent?

I presume now the distinction here between salary and total compensation earlier means just on wage and salary base. The percentage on that lower base is 21.5 percent for 1983.

I will skip to question 8, which asks about cafeteria plans, because we simply do not have any cafeteria programs.

Question 7 deals with what benefits are provided to employees in various salary ranges; what is the cost of these benefits, and what percentage of salary does the cost represent.

Well, 100 percent of Mobil Oil employees have each and every one of Mobil benefit plans available to them. There are no plans that are restricted to one employee versus another. As a matter of fact, our historic practice has been to provide the same benefit programs for the chairman who we still call chairman and the tank wagon driver that we now call truckdriver.

We did look at the highest paid and the lowest paid employees, and what the percentage of total compensation was in each of the five programs spelled out in the attachment. It is interesting to report that the retirement plan, the medical plan, and the disability programs all show a higher percentage of total compensation for the lower paid employees than the high paid employees.

The savings plan is a wash because we have a program that just offers a flat percent of pay for everybody in the plan and the life insurance program shows that the percentage of total compensation is higher for the highest paid employees than it is for the lower paid employees.

Thank you.

[Mobil submitted the following:]

SPECIFIC RESPONSES OF THE MOBIL OIL CORP., PRESENTED BY ROBERT B. PETERS, CORPORATE COMPENSATION AND BENEFIT MANAGER

Mobil would reply as follows to the specific questions of Chairmen Pickle and Stark in their letter of August 30, 1984:

Question. What is the cost of benefits provided to employees?

Answer. The total cost for tax-free or tax deferred benefit plans of Mobil Oil Corporation was $263,004,000 in 1983. (See Attachment A for plan-by-plan details and a 10-year earlier comparison).

Question. What percentage of total compensation does the total cost of benefits represent?

Answer. 17.6% of total payroll (See Attachment A).

Question. What is the cost of tax-free or tax deferred benefits provided to your employees?

Answer. $263,004,000.

Question. What percentage of total compensation and total cost of benefits does the cost of tax-free or tax deferred benefits represent?

Answer. All of the benefits in Attachment A are either tax deferred or tax-free. We estimate that the cost of benefits which are fully taxable (e.g., payment for time not worked) amounts to an additional 10% of total compensation.

Question. What is the per employee cost of both the total benefits provided and each type of benefit?

Answer. The cost per employee for Mobil Oil Corporation employees for 1983 was:

	Cost per employee
Retirement plan	$4,116
Savings plan	1,373
Life insurance	465
Disability	83

Medical	1,969
Total	8,006

Question. What percentage of the employee's salary does the cost of the benefit provided represent?

Answer. 21.5 percent.

Question. What benefits are provided to employees in various salary ranges? What is the cost of these benefits? What percentage of salary does the cost represent?

Answer. 100% of Mobil Oil employees have each and every one of Mobil's benefit plans available to them. Our historic philosophy has been to provide the same benefit programs for the chairman and the tank wagon driver.

Question. Are any benefits provided through a cafeteria plan?

Answer. No.

ATTACHMENT A.—TOTAL COMPANY COSTS OF FRINGE BENEFITS PROVIDED TO DOMESTIC EMPLOYEES—1983

[Dollars in thousands]

	Annual cost	Percent of total compensation
Direct compensation	$1,224,489	82.4
Benefits:		
Retirement plan	135,215	9.1
Savings plan	45,118	3.0
Life insurance	15,263	1.0
Disability	2,722	.2
Medical	64,686	4.3
Total benefits	263,004	17.6
Total compensation and benefits	1,487,493	100.0

TOTAL COMPANY COSTS OF FRINGE BENEFITS PROVIDED TO DOMESTIC EMPLOYEES—1973

[Dollars in thousands]

	Annual cost	Percent of total compensation
Direct compensation	$436,500	88.4
Benefits:		
Retirement plan	20,500	4.1
Savings plan	16,200	3.3
Life insurance	10,000	2.0
Disability	500	.1
Medical plan	10,600	2.1
Total benefits	57,800	11.6
Total compensation and benefits	494,300	100.0

Chairman PICKLE. I thank you gentlemen for your statements.

I regret I was not here to hear all of the statements.

I beg your pardon. The next witness is Mr. Howard Weizmann. You are manager of the benefits planning and design of the Sun Oil Corp. Mr. Weizmann, we will be pleased to hear your testimony.

STATEMENT OF HOWARD WEIZMANN, MANAGER, BENEFITS PLANNING AND DESIGN, SUN CO., INC.

Mr. WEIZMANN. Thank you.

Mr. Chairman, we welcome the opportunity to testify today concerning employee benefits at Sun. I call to your attention a fact sheet that we had supplied to the committee concerning the direct cost of benefits to Sun Co. There is a correction which I hope will be read into the record in those figures.

My calculator lied and in fact under tax deferred benefits for active employees only, tax deferred amounts represent 28.1, not 13.6 percent of benefits provided to active employees.

May the record be corrected on that?

One of the difficulties I have in coming to Washington is trying to understand whether we are talking here today about changing the pitcher or selling the ball team.

I find difficulty sometimes in understanding or comprehending the two issues that seem to be driving both tax policy and national policy with regard to employee benefits. Those two issues seem to be equity versus revenue.

In Sun's own experience, we have found that equity in fact costs money. If we are more equitable, it means we are providing benefits to a greater number of people, and we also are providing them at fair and usable replacement ratios in the case of retirement income—fair and equitable programs in the case of programs such as medical and life insurance. This costs money. You cannot do both at once.

We have also found that we can't simply spread out the benefits paid to higher paid employees to provide a larger proportion of those benefits to lower paid employees. The two issues of equity and revenue remind me of a professor that I once had in college who was both a sociology professor and an anthropology professor. When I question people down here exactly on issues of equity versus revenue, and point out that equity costs money, the response is similar to what my professor used to say when you asked him a sociology question; he said, I am an anthropologist. And when you asked him a question in anthropology, he used to say he was a sociologist. I don't understand that.

It is either a revenue issue or an equity issue. Caps which intend to promote equity and raise revenue don't work. For example, we found with regard to our experience most recently with the cap on the 415 limits of which Mr. Peters spoke a few minutes ago; that cap on the 415 defined benefit plan means that for an employee earning as little as $13,000 at Sun Co., that we can't fund his pension today for when he is going to retire in the year 2014 as we would be required under our own plan assumptions, reasonable as they are. Is this more equitable? Did it raise much revenue?

The other aspect that I have heard on the equity issue, or discussing the equity issue, seems to be that we have had all this growth in benefits, which means more people being covered, but that this growth costs money—particularly in the area of medical plans.

I have heard the figure of 80 percent coverage for medical benefits, and at the same time I have heard phenomenal figures in terms of the cost, all of which, as you can read by our own experience, are true. I fully believe that they are true.

Specifically, you cannot have this growth without spending money. You cannot have the equity evidenced by the coverage provided by these medical programs without incurring significant costs. My fact sheet will detail what in fact those costs are per employee at Sun. We must choose whether we want equity or revenue—you can't have both.

We have also been asked to isolate what kind of behavior or in fact which corporate behavior will change with regard to benefits. I have heard on the preceding panel a survey of CEO's and high level employees of various corporations indicating in fact what would happen to benefits at various corporations if the tax incentives were changed.

With all due respect to my own chief executive officer, and the officers of other corporations, they are probably not the right person to ask about the influence of tax policy on the design of benefit programs in a large corporation.

Why is there a belief that employers do not respond to tax policy? In fact, we have responded in the past to what tax policy is by providing benefits that aim at what those benefit levels are sanctioned by tax policy.

Today we have a limit, for example, under our life insurance program, of a maximum of $50,000 worth of life insurance. That $50,000 was not simply pulled out of the air, but in fact coincides very neatly with the section 79 limit for that very same insurance.

We responded like most major employers to the extension of salary reduction to 401(k) plans by instituting a similar kind of program in our own corporate context. We have found that fully 14 percent of those people who did not participate in our program prior to the institution of a 401(k) plan, I am talking about lower paid individuals, 14-percent more now save under Sun's retirement plan in response to that tax incentive, if you will, the 401(k) mechanism.

[The prepared statement and testimony subsequently received follow:]

STATEMENT OF HOWARD WEIZMANN, SUN CO., INC.

DIRECT COST OF BENEFITS PROVIDED TO EMPLOYEES OF SUN CO., IN OIL RELATED OCCUPATIONS AS OF 1983

Total benefit expense

In 1983, Sun Company spent $159,259,000 to provide retirement savings incentives, medical and dental, long-term disability and death benefits to 15,067 employees in oil and gas related occupations and approximately 9,000 retirees. Other benefits were provided, principally in the form of vacation, holiday and sickness and disability pay, which amounted to an additional expenditure of $77,140,000. For every dollar of total wages provided by Sun to its employees, another 41¢ was directed toward employee benefits.

Tax deferred, tax free and taxable benefits

1. Tax deferred benefits.—These benefits included pensions and savings incentives amounting to (excluding governmentally required payments) $69,818,000 for all active and retired employees and $58,298,000 for employees only. For active and retired employees, tax deferred amounts represented 29.5% of total benefits. For active employees only, tax deferred amounts represent 28.1% of benefits provided to active employees and 11.5% of total wages.

2. Tax free benefits.—Tax free benefits include medical, dental, death, sickness, gifts, educational reimbursement (in 1983), service recognition awards and travel and accident insurance. These benefits totalled $58,767,000 for all active and retired employees, or 24.9% of total benefits. For active employees only, tax free amounts represent $40,102,000 or 19.3% of benefits provided to active employees only and 7.9% of total wages.

3. Taxable benefits.—These benefits include vacation and holiday pay, long-term disability, certain direct retirement payments and total $70,677,000. These taxable benefits represent 29.9% of all benefits for active and retired employees. For active employees only, these benefits totalled $68,586,000 and represented 33% of all benefits provided to active employees and 13.5% of total wages.

Distribution of benefits

Sun Company provided benefits amounting approximately to $13,377 for each employee. For non compensation related benefits such as medical and dental insurance, this amounted to approximately $1750 for active employees ($1486 for retirees) and $156, respectively. Compensation related benefits, such as life insurance, averaged $168 per employee ($187 for retirees).

Although it is not possible to satisfactorily portray proportionate savings and retirement income as an average dollar contribution, Sun contributed an average more than $4.5% (out of a maximum of 5%) of participants' compensation who earned less than approximately $35,000 (67% of all participants), in the form of a matching contribution to Sun's defined contribution capital accumulation plan. Income replacement ratios provided under Sun's Retirement Plan as related to salaries are provided on the attached chart. The success of Sun's Retirement Program is further indicated by the fact that as of the end of 1982, fewer than .3% of Sun's retirees received public welfare or other assistance.

Responsiveness of private sector

Current tax policy permits employers to be responsive to the needs of employees and their dependents. In Sun's instance, this meant that since 1960 Sun could make up nearly one-half of the impact of inflation, at a cost of over $100 million, on retirement income and led to the development of Sun's retirement income protection program we call "Orbit". This also meant that when tax incentives were made available under Section 401(k) and Sun passed them on to its employees, an additional 14% of those who were not previously saving under Sun's savings program began to do so. Finally, when Sun became aware of the spiraling cost of medical payments, we shifted away from first dollar coverage and began programs which raised employee consciousness concerning medical costs. In part as a result of these efforts, the rate of increase in medical care costs have slowed from 26% in 1981 to a projected increase of only 7.7 % (the actual to date increase is 5.2%) in 1984.

APPROXIMATE RETIREMENT BENEFITS

[As a percentage of earnings at retirement]

Earnings at retirement	Percentage of employee population at earnings level	Percentages of earnings at retirement		
		Sun Co., Inc. retirement plan benefit payable at age 65	Social Security benefit payable at age 65	Total retirment income
$10,000 to $19,999	8.2	26	44	70
$20,000 to $29,999	51.7	32	32	64
$30,000 to $39,999	12.2	36	24	60
$40,000 to $49,999	12.5	39	19	58
$50,000 to $59,999	7.5	40	15	55
$60,000 to $69,999	3.0	41	13	54
$70,000 to $79,999	3.0	42	11	53
$80,000 to $89,999	.9	43	10	53
$90,000 to $99,999	.5	43	9	52
$100,000 +	.7	44	8	52

Notes.—(1) Retirement in 1984 at age 65 with 35 years of service. (2) Historical salary increases of 6 percent per year.

Statement of Sun Co., Inc.

Mr. Chairman, we welcome the opportunity to testify today concerning the future of employee benefits and economic security.

Today, the economic security of over 150 million Americans is being protected in some measure by the private benefit system. This economic security is comprised of disability programs which allow disabled employees to maintain their standard of living while encouraging rehabilitation to return to productivity; medical insurance programs which assist employees and their families to meet their medical expenses and to encourage health care; death benefit programs which protect dependents against loss of income at the time of an employee's premature death; and retirement programs which are designed to replace a reasonable portion of an employee's income at retirement. Most importantly, these programs supplement the government safety net of Social Security, Medicare and Medicaid.

These programs do not exist solely due to the good will of employers. As you will see, they are expensive. To make them affordable, Congress in its wisdom has provided tax incentives which lessen the cost to employers to provide them and permit the employee to devote the full benefit dollar for its intended purpose.

Do not pretend that if these tax incentives are withdrawn that employer behavior will not change. If current tax incentives for retirement, medical, death and disability are withdrawn or curtailed, employer sponsored programs will be likewise withdrawn or curtailed. Eventually, of course, they will be replaced by expensive government provided benefits, funded directly by tax dollars and, of course, by the large, inefficient, bureaucracy needed to administer them.

It is ironic that employee sponsored programs are being called into question at a time when their governmental counterparts are in financial crisis. Imagine the magnitude of these crises today if there was no private system. Imagine the crises of tomorrow if short-term revenue needs are allowed to drive these programs out of existence.

In order to divert attention from this peril, those who would curtail or eliminate the tax incentives have by sheer assertion convinced some members of Congress that these benefits go only to the rich. To be sure abuses exist. To be sure the coverage of these programs needs to be extended. However, the vast preponderance of these benefits are distributed equitably. At Sun, our CEO receives the same medical benefits as his secretary, he receives less in the way of income replacement from tax favored retirement programs. Moreover, despite the ups and downs of the national economy over the last fifteen years, fewer than .3% of Sun's retirees—people who retired at all levels of income—received public welfare as of 1982 (the last year figures were available).

We do understand the revenue needs of government must co-exist with national policy goals. We will be happy today, and in the future, to provide whatever assistance we can to assure that where limitations are placed they are rational and administrable. However, we will also speak out against those approaches which will jeopardize the economic security of our workers.

In the following pages, we first describe Sun's benefit program in some detail. Next, we describe the costs of this program. Finally, we discuss the distribution of these benefits.

I. SUN'S BENEFIT PROGRAM

The following discussion describes the specifics of Sun's benefit program and how it provides for our employees' welfare.

A. Retirement plan

Sun maintains a carefully designed retirement program which is intended to meet the replacement income needs of its employees. This program is made up of two plans. One is a defined benefit pension plan, the Sun Company, Inc. Retirement Plan, which provides fixed retirement income and serves as a typical employee's primary source of retirement benefits. This plan covers all regular hourly and salaried employees and retirees. It provides retirement benefits equal to (1⅔% times final average earnings times plan service up to 30 years) plus (¾% times final average earnings times plan service over 30 years) less (1⅔% times primary social security at age 65 times plan service up to 30 years). Examples of retirement income at various pay levels are as follows:

EMPLOYEES RETIRING JAN. 1, 1985 AT AGE 65 WITH 30 YEARS OF SERVICE

Final average pay	Plan benefit	Social Security	Combined retirement income	Percent of final average pay
$15,000	$3,890	$7,222	$11,112	74
20,000	6,076	7,849	13,925	70
25,000	8,474	8,055	16,529	66
40,000	15,843	8,321	24,164	60

B. Sun capital accumulation plan (SunCAP)

The other part of Sun's retirement progam is a defined contribution plan, which is called "SunCAP." This plan combines a cash or deferred arrangement (401(k)) with a thrift plan feature. The first 5% of employee pre-tax contributions are matched dollar for dollar by employee contributions. Upon termination of retirement, an employee's account balance is made available in the form of a lump sum. More than 80% of all regular eligible employees participate in SunCAP.

C. Post-retirement increases

Sustained periods of inflation seriously threaten any retirement program. As in many companies, Sun's retirement program is linked to pay and, in this way, keeps pace with changes in the standard and cost-of-living which occur during an employee's career. However, this self-adjusting mechanism stops at retirement, leaving retirement income vulnerable to even modest rates of inflation. For example, the income of a Sun worker who retires on a pension of $1,000 per month, assuming an inflation rate of 5% per year, will be worth $783 after five years in real dollars; after 10 years, the individual's pension will be worth only $613.

In the past, Sun responded to the impact of post-retirement inflation by periodically granting non-qualified supplemental payments, payable from its general assets, which increase the basic benefits provided under the retirement plan. Sun granted ten such increases between 1960 and 1983 which made up for almost half of the impact of inflation. The present value of these previous increases is approximately $100 million.

Sun subsequently developed the Optional Retirement Income Truat ("ORBIT") Program which protects retirement income and is designed to augment basic benefits without changing the underlying design of Sun's qualified plans. It is designed to encourage employees to dedicate a portion of their account balances in SunCAP to the purchase of retirement income.

Under Sun's ORBIT program, participants in the Sun Retirement Plan and SunCAP who retire are given an option under SunCAP to purchase an annuity from their accumulated account balances. The employee pays only a portion of the full cost of the annuity and Sun pays the balance. The ORBIT annuity provides, in effect, a total of 15 annual supplemental retirement income increases. Beginning in the second year of retirement and for each of the nex 14 years, the annuity pays an increase equal to 3% of the benefits paid in the prior year form both the basic Retirement Plan and ORBIT. This compounds, so that by the 15th year of retirement, the retiree's income has increased by 56% (3% compounded 15 times). At that time, the augmented retirement income remains level for life. The annuity also contains a 50% survivor benefit coupled with a refund feature which preserves the employee's contributions used to meet a portion of the cost of the annuity.

The following example illustrates how Sun's ORBIT program works:

Frank retired on January 1, 1984 at age 62. His basic retirement benefit is $585 per month. He learns from Sun that an ORBIT annuity would cost $10,498. He pays 15% of the cost—or $1,575—and Sun pays the other 85%, or $8,923. During his first full year of retirement, Frank receives $585-per-month benefit from the Sun Company, Inc. Retirement Plan (SCIRP) or $7,020 for the year. The following year, that benefit is boosted by 3% or $17.55. Frank would receive this amount in a check from an insurance company, bringing his monthly retirement income from Sun's plans to $602.55. His total benefit in that year would increase from $7,020 to $7,231 for an increase of $211. The following chart describes how Frank's benefits grow annually:

Year of retirement	Total annual benefit (SCIRP plus ORBIT)	Annual ORBIT increase over SCIRP
1	$7,020	
2	7,231	$211
3	7,448	428
4	7,671	651
5	7,901	881
6	8,138	1,118
7	8,382	1,362
8	8,633	1,613
9	8,892	1,872
10	9,159	2,139
11	9,434	2,414
12	9,717	2,697
13	10,009	2,989
14	10,309	3,289
15	10,618	3,598
16 and (thereafter)	10,937	3,917
Accumulated ORBIT increase		29,179

By the time Frank has received all 15 increases, his retirement income from Sun plans has grown to $10,937 annually or $911 per month, and it remains at that level for the rest of his life. When he dies, his surviving spouse receives 50% of the $911 monthly benefit, or $456 a month.

As can be seen from this example, Sun's ORBIT program is intended to benefit employees by: increasing their retirement benefits; guaranteeing the source of those benefits during retirement years; providing flexibility in the approach toward funding the benefit at retirement; and encouraging employees to save for their retirement years. Under current law, the full implementation of the Orbit Program cannot be achieved since the current contribution limits to defined contribution plans prevent a large company contribution at the end of an employee's career. Legislation introduced in the House by Representatives Kennelly, Pickle and Archer as H.R. 4530 and in the Senate by Senators Chafee, Baucus and Bentsen as S. 1066 would correct these limitations and allow Sun to assure retirement income protection to its retirees.

D. Medical programs

Due to high cost of medical care toady, few individuals can afford to "go it alone" when they become ill or need expensive surgery. To help meet these financial responsibilities when these events occur, Sun provides a Medical Program for all of its regular employees, as well as retirees and their dependents for life.

Additionally, if an employee dies, Sun will continue coverage for all eligible dependents for six months free of cost. The employee's dependents may continue the coverage beyond this time by making any necessary employee contributions. Coverage may continue for a period equal to the employee's years of completed company service.

The type of medical coverage which Sun provides is what industry calls "comprehensive" medical coverage. It has no lifetime maximum benefit, provides coverage for a wide range of health care treatment and places a limit on out-of-pocket medical expenses which the employee would have to pay in one year.

An example of how this program specifically works is as follows:

Example: Suppose John, an employee should be hospitalized after suffering a heart attack. Upon discharge, he convalesces at home for six weeks. This example shows what his bills would have been and what benefits he would have received under Plan III. (Assume John has not incurred any covered medical expenses this year.)

EXPENSES COVERED BY PLAN III

Type of service	Bills	Comprehensive coverage (No deductible)	Comprehensive coverage $150 deductible
Ambulance to clinic	$40		$40
Emergency medical care (outpatient hospital)	300		300
Emergency doctor's care	150		150
Hospital room and board, 15 days at $300 per day	4,500	$4,500	450
Hospital miscellaneous expenses	8,000	7,200	800
Surgery	1,000		1,000
Consultation	200		200
Special nurses	900		900
Doctor's visits at home	200		200
Outpatient drugs	250		250
Outpatient hospital tests	900		900
Total	16,440	11,250	5,190

Plan III would pay:

Benefits payable with no deductible	$11,250
Of the $5,190 in expenses subject to the $150 deductible, John would pay 75% of the balance	3,780
The remaining expenses of $1,410 exceed the out-of-pocket limit on employee medical expenses ($1,000), so the Plan pays expenses above the limit in full, so $1,410 − $1,000 =	410
For a total benefit of	15,440
So, of the total bills of	16,440
Plan III would have paid	15,440
John would have paid	1,000

Sun also provides dental coverage to all active employees.

Sun is also very concerned about the rapid escalation in the cost of medical goods and services in this country and has taken numerous steps towards cost containment and the effective management of such plans. These have included movement away from first dollar coverage as well as accomplishments as developing a Health Maintenance Organization in the Philadelphia area, implementing a comprehensive Medical plan as a lower cost option for active employees, and beginning a nurse consultant program which conducts utilization review and monitors the cost and quality of medical care provided. Since 1981 when these programs began, the rate of increase has been reduced from 26% to a current projected rate of 7.7%. (Actual experience in 1984 suggest that the rate of increase will only be about 5.2%)

E. Death benefits

Sun Company also provides all regular employees with life insurance which is payable to a beneficiary in the event of an employee's death before or after retirement. The Plan offers non-contributory life insurance equal to one times base compensation up to a maximum of $50,000 and supplemental insurance up to three times compensation so an employee may choose the type of coverage which best suits his/her needs. The Company pays the cost of the non-contributory coverage under the Plan. A portion of this life insurance protection is provided after retirement as well.

In addition to Sun's Death Benefit Program is an automatic 25% spouse's pension in case of an employee's death. This coverage is provided for all active employees once they become eligible for early retirement. The cost is satisfied totally by Sun. The employee may also elect an additional 25% spouse's pension which is financed through a reduced benefit at retirement or for the spouse upon the employee's death prior to retirement. After retirement there is an automatic 50% spouse's pension provided at company expense.

F. Additional benefits

Sun also makes contributions to its Payroll Employee Stock Ownership Plan for every regular employee and like most employers, provides benefits for time not worked such as up to six weeks vacation; educational assistance which provides all regular employees with 90% of the cost of any approved course of a recognized educational institution to further his/her career; a scholarship plan whereby children, of active, deceased or retired employees may compete for scholarship assistance; and a matching gift plan whereby Sun matches the amount of a personal gift of money or securities that an employee or retired employee contributes to a domestic educational institution. Sun also provides an amount equal to the employee's personal contribution to a qualified community organization.

II. DIRECT COST OF EMPLOYEE BENEFITS TO SUN

A. Total benefit expenditure

Sun Company, Inc. is an integrated oil company with approximately 35,000 employees world wide. In oil-related occupations, Sun employs approximately 15,000 employees and has about 9,000 retirees. In 1983, Sun Company spent $159,259,000 to provide basic benefits to all rgular employees and approximately 9,000 retirees. This included expenditures for the following benefits:

	Expense	Percent of total
Core benefits:		
Pension obligations	$51,967,000	32.6
Medical insurance	39,756,000	25.0
Legally mandated payments (FICA, FUT, SUT, Worker's compensation)	37,137,000	23.3
Sun capital accumulation Plan (SunCAP)	19,322,000	12.1
Long-term disability	4,507,000	2.8
Death benefits	4,213,000	2.6
Dental insurance	2,357,000	1.5
Total	159,259,000	99.9

Of these amounts, $127,637,000 was the expense accrued to active employees, while $28,146,000 was accrued on behalf of retirees. This latter amount includes $11,370,000 attributable to retirement, $13,377,000 attributable to post retirement medical payments and $1,685,000,000 attributable to death benefits.

Sun also provided additional benefits totalling $77,140,000. The largest component of this figure were amounts expended for time not worked which may be broken down as follows:

Vacation	$40,785,000
Holiday	18,300,000
Sickness and disability	10,301,000
Other absences	2,000,000
Total	71,386,000

In 1983, Sun paid $485,018,000 in the form of base wages. If the time not worked is subtracted from these base wages (i.e. $485,018,000 less $71,386,000), the remaining base wage figure for time actually worked is $413,632,000. Total compensation for 1983 less time not worked was approximately $507,614,000. The total cost of benefits expensed on behalf of active and retired employees was $236,399,000. The total cost of benefits expensed for active employees, only, was $207,591,000 ($127,637,000 plus $79,954,000). The percent of base wages represented by this figure was in 1983, therefore, 50.2% (i.e., $207,591,000 divided by $413,632,000). Thus, for every dollar Sun spent in 1983 on base wages, another 50¢ was used to provide benefit coverage. As a percent of total compensation (less time not worked), $207,591,000 divided by $507,614,000, this figure is about 41¢.

On a per employee basis, total company provided benefits average annually approximately $13,377,000 for each employee ($207,591,000 divided by 15,067 employees). The average cost of medical insurance to employees was in 1983, $1750. (For retirees, this cost was approximately $1486). The average cost of dental benefits for employees was $156. The average cost of death benefits (which are compensation related) to employees was $168. (For retirees, this cost was approximately $187). The average company expense per employee for SunCAP was $1282. Given the group nature of benefits provided under Sun's retirement plan, a defined benefit plan, an average figure of these costs would have little or no meaning and none is presented.

However, on average, the Retirement Plan contribution averages 7% to 9% of base wages.

The costs of administering these benefits in 1983 was $5,998,000 or 2.5% of total benefits expense (i.e. $236,399,000).

B. Costs of taxable, tax deferred, tax free benefits

These benefits may be further categorized as taxable, tax deferred and tax free. Tax deferred benefits include pensions and capital accumulation amounts. Sun's cost of providing tax deferred benefits to active and retired employees (treating governmentally required payments as tax neutral for this purpose and excluding certain direct, unfunded obligations) is $69,818,000. This represents 29.5% of total benefits for active and retired employees. For active employees only, these tax deferred amounts represent $58,298,000 or 28.1% of benefits provided to active employees, 14.1% of base wages and approximately 11.5% of total compensation.

Tax-free benefits on the other hand include medical, dental, death, sickness and disability, gifts, educational reimbursement (in 1983), service recognition awards and travel and accident insurance. These benefits total approximately $58,767,000 for all active and retired employees. This represents approximately 24.9% of total benefits. For active employees only, tax free amounts represent $40,102,000 or 19.3% of benefits provided to active employees, 9.7% of base wages and 7.9% of total wages.

Taxable benefits, including vacation and holiday pay, long-term disability, certain direct retirement payments, total for active and retired employees, $70,677,000, and $68,586,000 for active employees only. These taxable benefits represent 29.9% of benefits expense for all active and retired employees. For active employees only, taxable amounts represent 33% of all benefits provided to active employees, 16.6% of base wages and approximately 13.5% of total wages.

Legally mandated payments make up the remainder of the total benefits expense. These are comprised of F.I.C.A. ($30,021,000), F.U.T. ($1,216,000), S.U.T. ($2,424,000) and Worker's Compensation ($3,476,000). These total $37,137,000 or 15.7% of total benefits. This approximates 9% of base wages and 7.3% of total compensation.

III. DISTRIBUTION OF BENEFITS

While it is difficult, if not impossible, to break down these benefits directly by salary ranges, what evidence exists suggests that these benefits are equitably distributed as a percent of salary. In the case of the pension income replacement, when a portion of the social security benefit is taken into account income replacement is generally higher for the lower paid than is available for the higher paid. The following table illustrates the relative income replacement ratios provided by the Sun Retirement Plan and Social Security:

APPROXIMATE RETIREMENT BENEFITS

[As a percentage of earnings at retirement]

Earnings at retirement	Percentage of employee population at earnings level	Percentages of earnings at retirement		
		Sun Co., Inc. retirement plan benefit payable at age 65	Social Security payable at age 65	Total retirement income
$10,000 to $19,999	8.2	26	44	70
$20,000 to $29,999	51.7	32	32	64
$30,000 to $39,999	12.2	36	24	60
$40,000 to $49,999	12.5	39	19	58
$50,000 to $59,999	7.5	40	15	55
$60,000 to $69,999	3.0	41	13	54
$70,000 to $79,999	3.0	42	11	53
$80,000 to $89,999	.9	43	10	53
$90,000 to $99,999	.5	43	9	52
$100,000+	.7	44	8	52

Notes.—(1) Retirement in 1984 at age 65 with 35 years of service. (2) Historical salary increases of 6 percent per year.

In the case of Sun's Capital Accumulation Plan, the average company matching contribution for employees who fall into the lower two-thirds of eligible participants is greater than 4.5% out of a maximum 5%. In the case of medical benefits, the same coverage is afforded to all employees at the same dollar cost. This means that as a percent of salary, lower paid employees benefit at a higher rate. While certain additional retirement, life and other more minor benefits are provided to Sun's senior executives, these are generally not tax deferred nor tax free and on the whole constitute a very small expenditure in comparison to the rest of these benefits. For example, amounts provided directly to active and retired executives which were neither tax free nor tax deferred under Sun's executive retirement plan in 1983 totaled $3,100,000 or only 1.3% of total benefits provided to all employees and retirees. This amounted to .6% of total compensation.

Naturally, we will be happy to work with the Committee to provide further documentation as to the equitable distribution of employee benefits.

IV. TAX POLICY AND BENEFITS

As you can see, Sun has a very strong benefits program. This program would be severely eroded if tax incentives as they currently are designed did not exist or were limited in the degree of deductibility.

Post-retirement benefits such as medical and life insurance would most likely be the first to be curtailed if significant funding or deductibility restrictions were placed on such benefits. Plans such as the educational assistance, scholarship support, and matching gift plans would likely be the next to be eliminated. Finally the medical and life insurance coverages for active employees of all salary levels would be reduced to coincide with any future limitations.

Company support for pension plans would also be reviewed in light of Congressional amendments which affect pension plans. One can expect over the long run that amendments which make retirement plans more expensive or to deny advanced funding of future pension obligations such as the current freeze on cost of living adjustments to the maximum limitations on contributions to qualified plans [1] will force Sun to ultimately reduce retirement benefits by decreasing the amount employees receive as a percent of final average earnings. Sun would also not be inclined to provide funds which augment pension benefits for retirees through our current ORBIT Plan.

Sun's retirement and welfare programs are designed to provide financial security and independence for employees, which are long-standing national policy goals. Without the current tax incentives Sun would be less inclined to develop new programs and would likely reduce existing benefits to coincide with new limitations, providing employees and retirees with lowered level of security. To the extent these incentives are "rolled-backed" by Congress, financial independence must be replaced by dependence on the public systems which are far more inefficient, inappropriate and costly than Sun's current programs.

Chairman **Pickle**. Thank you.

Mr. Winters, vice president of the Prudential Insurance Co.

STATEMENT OF ROBERT C. WINTERS, EXECUTIVE VICE PRESIDENT, PRUDENTIAL INSURANCE CO. OF AMERICA

Mr. **Winters**. In point of fact, I am executive vice president, but as long as the company maintains that distinction I am happy to be here on the basis you describe. Although our business is insurance, I am appearing here today on behalf of an employer whose benefit plans cover some 220,000 U.S. employees and their dependents.

I will, as Mr. Stark requested, simply summarize what is in our written testimony. We try to make four points:

First, the deficit is a much more important problem than seems to be recognized in the Nation at large currently. We need to attack this complacency, and I urge the subcommittee to continue the efforts which I know you have been putting forward, to raise awareness of this issue. That awareness is necessary before any of the problems can be——

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[1] Sun drafted testimony as of July 28, 1983 on behalf of the Association of Private Pension and Welfare Plans which demonstrated the impact of a permanent freeze under such limits. Under even reasonable assumptions such a freeze reduces current funding for a retiree who earns as little as $13,000.

Chairman Stark. Will you speak into the microphone or pull it a little bit closer to you.

Mr. Winters. Yes, sir. I am sorry.

I am simply urging that the nation as a whole has to have a clearer awareness of the deficit problem and what it portends for us, before we can effectively marshal support for the kinds of answers which are required. We applaud the course you are on.

Second, the employee benefit system which we have in place now is functioning well, to provide needed basic financial security for most working Americans and their families. That point has been covered in prior testimony.

Third, tax preferences for employee benefits are an important contribution to the success of the plans. You have heard from a panel of economists. I didn't have the benefit of all of it, but the essence of their testimony was that employees behave as rational economic people, and that their choices are driven entirely by the economics of the selections made available to them. The economists undertook to predict how employees would behave if certain changes in the Tax Code were made.

The fact is that employees have not historically behaved nor have I, nor I suspect has anyone else in this room, as purely economic animals in dealing with the choices which we face in our lives. The preference of employees, particularly recently, has been cash compensation over benefits, and if benefits do not have some additional appeal, over time the contract, whether formal or informal, negotiated between employers and employees, will shift in the direction of cash.

I think there is a very important point of how will people behave. I think it deserves more research than it has received, and I would certainly urge you to ask employers and employees how they will behave and why, not economists, and to look at how they have in fact behaved in the past. We have a very vivid although small example in the recent history of the Prudential.

For some 50 years we have provided free meals to our employees in our Newark, NJ, location. This without tax to them, the kind of tax arbitrage which is pointed to in these kinds of discussions that both we and the employees are better off and there is a revenue loss to the Treasury.

We recently discontinued that arrangement. We increased our employees' taxable wages and started charging them for lunches. The reason was that they did not value the tax preference lunch as much as they did the compensation, even though economic rationality says they should have, but that is the way people are.

Finally, and an extension of that point, what you do here can have very great impact. If these committees and the Congress significantly reduce tax preferences, there is a very serious risk of damage to an effective system for delivering needed benefits, damage which in fact could well increase the deficit rather than decrease it.

That is the essence of our written testimony. I would like simply to add one point in connection with the questions which have arisen concerning future increases in tax preferences to benefits. For a relatively stable employer with mature benefit plans, there are two principal sources of increase in benefit costs, Social Security tax increases and medical cost care inflation. I can think of no one in this room or probably anywhere else in a better position than you to estimate whether we will face increasing Social Security taxes in the future. It is currently our largest tax preference benefit for our employees.

The medical care cost inflation issue is a vital one which has already received considerable attention. We would simply add that it ought to be addressed directly rather than indirectly through elements of the Tax Code that affect only working Americans. Thank you.

[The prepared statement follows:]

STATEMENT OF ROBERT C. WINTERS, EXECUTIVE VICE PRESIDENT, PRUDENTIAL INSURANCE CO. OF AMERICA

My name is Robert C. Winters. I am an Executive Vice President at the Prudential Insurance Company of America. Although or business is insurance, we are testifying today as an employer, whose benefit plans cover more than 220,000 individuals—employees and their dependents.

The employee benefits structure in the United States is an excellent example of tax incentives inducing behavior which serves social and economic policy goals. This structure provides basic financial security to millions of American workers and their families. It is working well; any significant tampering with it entails considerable risks.

I do not mean to suggest that tax preferences for employee benefits should go unexamined when the Federal deficit approaches 200 billion dollars. The Prudential believes very strongly that there is too much complacency in the nation about our fiscal situation. We applaud the actions of the Ways and Means Committee in addressing this problem. We hope that you will continue your efforts to draw attention to the importance of the deficit issue.

On the revenue side, all tax preferences, certainly including employee benefits, should receive scrutiny. Perhaps more importantly, although less directly the immediate concern of the Subcommittees, all categories of expenditures must also be subject to scrutiny.

While acknowledging that the tax treatment of employee benefits warrants examination, I suggest that this area is an unlikely source for substantial reduction of the deficit. The economically significant, tax-preferenced employee benefits are coverage of health care and pensions. As a nation, we have made a commitment to defray both the costs of our workers' health care and the cost of a decent retirement. The only question is how these costs will be met. If we inhibit the private sector in meeting these needs, we simply increase the burden on the public sector. We might increase tax revenues, but there is substantial likelihood that we would increase public expenditures even more; and, that is no way to reduce a deficit.

We believe there is general agreement that the legitimate costs of health care and retirement must be met by our society. Yes, there are excessive costs in our health care delivery system, but that problem should be addressed directly and comprehensively—not indirectly through tax code changes that affect only workers and their families.

I would urge the Subcommittees to consider carefully whether there is any more cost-effective way than the one now in place for the nation to meet these health care and retirement costs. The structure we have is working—not perfectly, but well. Any significantly different structure involves major risk of increasing the deficit. Minor changes cannot achieve much in dealing with the deficit, and may impede the currently effective use of tax preferences to energize efficient private sector responses to important social needs.

I would like to use my remaining time to address some of the specific issues you have put forward. Many of your questions call for statistical responses and we have answered them in an appendix to this testimony.

Some of your questions imply a concern that employers and employees are conspiring to abritrage against the tax code—that we agree on total compensation and then decide what compartments to put it in for tax advantage. I have already acknowledged the effectiveness of tax incentives to motivate behavior in the private sector, but that does not add up to a rip-off of other taxpayers. The driving force in employee compensation over the past few years has been towards cash, not benefits.

In the Prudential's case, the voluntary increases in our compensation to our employees over the last four years—voluntary, as distinguished from the inflationary increases which we had to pay in our health insurance premiums—the voluntary increases were more than seven-to-one cash versus benefits. For our total employee group, we increased cash compensation 235 million dollars during this period, while making voluntary increases in our benefit costs of 31 million dollars.

This is sound evidence that the nation does not face a runaway tax loophole.

Secondly, you asked whether we have any benefits provided through a cafeteria plan. We do not—regrettably. A year ago we decided to develop a cafeteria plan to be effective January 1, 1985. We had two objectives: to give our employees choices, and through those choices to involve them in decisions affecting health care costs. We anticipated that a well-designed cafeteria plan would reduce costs for both our employees and for the company. The IRS limitations on cafeteria plans announced last spring stopped us. We are working on a limited alternative, but it can not incorporate the cost-containment features we had originally targeted. I hope that one result of your examination will be a thorough reconsideration of the trade-offs available in well-designed cafeteria plans, which include appropriately limited flexible spending accounts.

Finally, I would like to point out an adverse impact of Congressional activity over the last decade. Employee benefits, particularly pension benefits, are very long-term commitments by employers. We need to plan for these commitments over the working lifetime of our employees—periods which often exceed forty years. In the ten years since the passage of ERISA, this kind of long-term planning has become increasingly difficult because of the proliferation of new law. As illustrated in the accompanying chart, we have seen a myriad of legislation affecting employee benefits, including twelve major tax acts, in the last decade. For the private sector to continue its successful record of developing cost effective employee benefits it needs more stability. Frequent, revenue-driven changes are destabilizing the process.

To summarize, we share your concern about the deficit. We do not see the employee benefits area as offering significant opportunity for closing the deficit gap. The employee benefits system in the United States is working well and should not be changed significantly. Our recent experience at the Prudential suggests that concern over significant erosion of the revenue base by employee benefits is misplaced. I commend you for beginning a very important process—and I urge you to let us participate actively with you to find a set of answers that will curb the deficit and lead to a stable set of employee benefit rules.

THE DISTRIBUTION AND ECONOMICS OF EMPLOYER-PROVIDED FRINGE BENEFITS

(1) What is the total cost of benefits provided to employees?

The total cost of providing benefits to employees and Special Agents during 1983 was $471,411,097.

(2) What percentage of total compensation does the total cost of benefits represent?

The total cost of benefits during 1983 represented 25.5% of total compensation.

(3) What is the cost of tax-free or tax-deferred benefits provided to your employees?

The cost of tax-free benefits provided during 1983 was $242,568,349. The cost of tax-deferred benefits provided during 1983 was $79,005,813.

(4) What percentage of total compensation and total cost of benefits does the cost of tax-free and tax-deferred benefits represent?

Tax-free benefits provided to employees in 1983 represented 13.1% of total compensation and 51.5% of the total cost of benefits.

Tax-deferred benefits provided to employees in 1983 represented 4.3% of total compensation and 16.8% of the total cost of benefits.

(5) What is the per-employee cost of both the total benefits provided and each type of benefit?

Average per-employee cost of benefits provided during 1983

Medical/dental benefits	$1,532
Disability	440
Group life insurance benefits	134
Retirement plan benefits	827
Prudential investment plan	409
Government-mandated benefits	1,540

Other miscellaneous benefits	2,493
Total benefits	7,375

(6) What percentage of the employee's salary does the cost of the benefits provided represent?

The cost of benefits provided to employees in 1983 represented 34.13% of average employee compensation of $21,605.

(7) What benefits are provided to employees in various salary ranges? What percentage of salary does the cost represent?

Salary range and Benefit plans provided	*Percent of average Ee compensation*
All Employees:	
Medical/dental	7.09
Disability	2.04
Group life	.62
Retirement	3.83
Prudential investment plan	1.89
Government mandated	7.13
Miscellaneous	11.54

Executive:

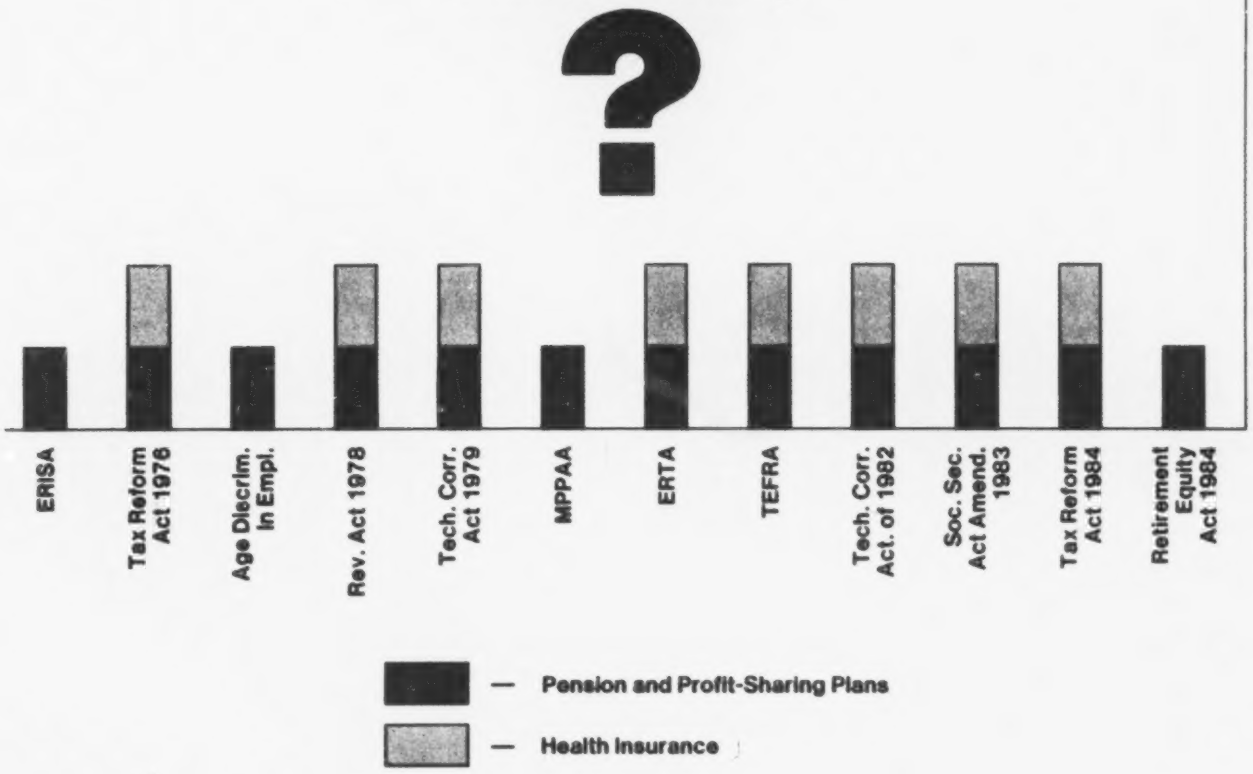
Retirement.—No early retirement reduction if at age 60 with 25 years of service (instead of 30). Provided under a nonqualified program, i.e., financed on a cash disbursement pay-as-you-go basis. There are some recipients. Benefits are taxable.

Disability.—10 year's of service eligibility requirement waived. Applicable to those at FVP rank or above. Provided under a self-insured program. There are no recipients. Benefits would be taxable when received.

(8) Are any benefits provided through a cafeteria plan? If so, which ones?

No.

Tax Stability



Chairman Pickle. Mr. Winters, did I understand you to say that in recent years you offered employees a chance to increase their base, although it was taxed, that they preferred that route to tax-free benefits?

Mr. Winters. Yes, sir. I referred to a particular example having to do with the tax-free meals. I can give you a somewhat broader one. Over the last 4 years our increases in compensation as between cash and voluntary increases in benefits—I distinguish the involuntary increases from inflation—have been 7 to 1 cash over benefits.

Chairman Pickle. Does that mean that your company then has a policy that it is going to reduce fringe benefits or employee benefits and yet increase the base? Is that a policy of your company now?

Mr. Winters. Our policy is to try to provide a total compensation package which seems to accord most closely with what our employees want—and our reading of our employees is certainly reinforced in the case of our union represented employees by the collective bargaining discussions—our reading is that our employees want cash.

Chairman Pickle. Aside from what the employees want or what you want for them or don't want for them, what should we do with respect to employee benefits? Should we the Congress let them alone or should we attempt to set some kind of control or limitation on them? Do you think they will continue to grow? Does the panel think that they will?

Mr. Weizmann. Mr. Pickle, there was a study, I know, conducted that demonstrated, at least it is my understanding or the reading of it, that employee benefits have grown as inflation forced people up in the tax brackets, obviously it became more attractive. That is on a macro basis.

Speaking from my own experience, we are looking for ways, and I think it is borne out in the medical plan area, ways in which we can share costs with employees, not only for medical benefits, but in the post-retirement increase area, which I know you are familiar with. We are looking for ways in fact to share some of the costs of the employer-provided program with employees. With that shifting, my guess is that in fact a significant reduction in usage will occur.

That happened in our medical plans, for example, when we shifted from first-dollar coverage to a deductible, we achieved a reduction in the growth in benefits from 1981 of 26 percent down to a projected increase for this year of 7.7 percent, and the actual increase to date is 5.2 percent in medical costs.

We are looking for ways in which we can fairly shift some of the benefit costs to employees, and with that I fully believe that some of the usage will also go down.

Chairman Pickle. I have a little difficulty finding an answer to my question. Do you think that employee benefits are going to grow in your industry?

Mr. Weizmann. No.

Mr. Peters. I would like to echo that, Mr. Chairman. I see by the history we have provided that in the last 10 years there was a significant growth in the tax-deductible expenditures in Mobil Oil Corp. for employee benefits. Now, that was not driven solely by the fact that it is a tax-deductible expense. The economics of the industry had an awful lot to do with it.

I think you will see that the costs I have shown for 1983 for Mobil Oil tax-free or tax-deferred expenses is significantly higher than what we will show for 1984. Again, we are not looking for a tax deduction. The economy of our industry has changed. We are looking for ways of economizing. Employee benefits is a very big one. The pension plan and the medical plan are two of the greatest.

Now, we like the tax deduction, but there is more of an economic reason for spending money on benefits than just taxes.

Chairman PICKLE. None of us know whether these benefits will grow or not. Perhaps we have peaked out in the last 2 or 3 years. It could peak up again in the next two or three quarters too, or they could even have declined. That is why we are trying to make up our mind. What is going to happen to them? I recognize that in many of the industries there is a leveling off, but we don't have enough of a history to show that that is going to be the level, or whether it is just a temporary lull before further escalation, so we are trying to find that out.

Let me ask you, with respect to each one of you, do you think some of, for example, educational benefits—that is a good example—should Congress review that program, institute it again, allowing the tax deductibility by the employee, and no income status on the part of the employee? Is it the type of program that the industry would want?

Mr. PETERS. I would have to answer for Mobil Oil Corp., very positively on that, yes, sir.

Chairman PICKLE. Would you all be for it?

Mr. WINTERS. I am sorry, were you saying are we all for it?

Chairman PICKLE. I am asking you, are you for that?

Mr. WINTERS. Congressman, I continue to believe that the first problem which we need to be addressing, and which of course particularly the Ways and Means Committee needs to be addressing, is the deficit. I think that any proposals which increase the deficit and further tax deductibility of employee benefits would have risk of increasing the deficit, have to be very suspect at this point in our economic history.

I believe that we have to marshal the forces of all of the people involved to try to figure out how we are going to deal with the deficit, and I believe that specific individual questions of this sort are really subordinate to that larger issue.

Chairman PICKLE. Inasmuch as the educational system program expired last December, and inasmuch as we may or may not settle this deficit question for some time to come, should we then set the educational system on the shelf and look at it in another 2 or 3 years from now?

Mr. WEIZMANN. Mr. Pickle, may I respond? I believe that things such as educational assistance, particularly educational assistance where we, for example, in a mature industry are dealing with retraining costs, re-education of our employees who are either going to leave us or are leaving us in fact because of shifts in the open market with regard to oil over which we have no control, that this benefit is very useful to us, and I think we would echo what Bob

Peters said with regard to we would like to see a continuation of that.

Mr. PETERS. It is an extremely popular program.

Chairman PICKLE. Mr. Winters, have you changed your educational system program, your tax program within the company in any way?

Mr. WINTERS. No, sir, we have not.

Mr. PETERS. I wanted to add, sir, the reason we feel so strongly on that program is our review shows quite clearly that it is the minority and the lower paid, lesser educated employee that by and large takes the far greatest advantage of that program, and it disturbs us greatly to see that taken away from them.

Chairman PICKLE. If it was restored, would you be for or against including the FICA and the FUTA tax with respect to those benefits?

Mr. PETERS. I think I would like to review the effect of this first on employees, but I have to say I have less of a problem of including elements in tax bases that produce benefits in the future, and I think FICA clearly falls under that category, whereas income tax would not. In a way, I am saying yes to your question but I would hesitate to answer it without further study.

Chairman PICKLE. Tentatively yes.

Mr. WEIZMANN. I hate to sound like a "me too," but me too.

Chairman PICKLE. You want to settle the deficit first. You can hide behind that one.

Mr. WINTERS. I——

Chairman PICKLE. I want to say to you and the others, this committee, this Congress is not looking for ways to reduce employee benefits. They have been added with our concurrence and understanding for years. In many respects they are delivered more economically and efficiently than we the government could give them.

We also recognize that there has been a tremendous growth in them, and we have to ask ourselves again how much will they continue to grow, and if they are leveled off, what assurance do we have that they will keep at that level, and what effect does it really have on the tax base with respect to our income.

These are questions we are looking at, and contrary to what some of the organizations may say, we are not starting any kind of a scare campaign, and we don't hope that the industry or the employees start the same thing. But I think this committee is going to continue to look at this question, because it is fundamental, it is serious, and it deserves further study.

If you have other statements or other comments to make to us, we will be glad to have it, but in the meantime we appreciate your testimony very much.

Mr. WEIZMANN. Thank you.

Chairman PICKLE. The next witness is Mr Robert Georgine, chairman of the National Coordinating Committee for Multi-Employer Plans. Will you introduce the other gentlemen with you.

Mr. GEORGINE. I have with me Jack Curran and Peter Schmidt.

Chairman PICKLE. Glad to have both of you gentlemen. If you will proceed.

STATEMENT OF ROBERT A. GEORGINE, CHAIRMAN, NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS, ACCOMPANIED BY JACK CURRAN, LEGISLATIVE DIRECTOR; AND PETER SCHMIDT, ATTORNEY

Mr. GEORGINE. Mr. Chairman, my name is Bob Georgine, chairman of the National Coordinating Committee for Multiemployer Plans, an organization that represents the interests of the more than 8 million working men and women, and their families, who are covered by multiemployer plans.

The NCCMP and its affiliates welcome this opportunity to testify, since we are deeply concerned about the continuing viability of collectively bargained employee benefit plans. These plans provide a wide range of essential benefits to workers who generally could not otherwise afford them, and thus serve a number of important public policies.

A more detailed discussion of these benefits, the workers who are covered by them, and other points covered by the questions set forth in the subcommittees' press release is contained in a written statement we will submit later in the week.

Chairman PICKLE. It will be included in the record in its entirety.

Mr. GEORGINE. Despite the important social policies referred to above, a disturbing trend appears to be developing—a trend to curtail the Federal tax incentives that have played a key role in the development of benefit funds.

Several factors appear responsible. First, the continuing Federal deficits have created intense revenue pressures. Reducing the tax-favored status of employee benefits appeals to some as a low-visibility way to generate additional revenues. In our view, however, this nation cannot justify any attempt to balance the Federal budget on the backs of the working men and women of this country.

Our workers and their families depend on the retirement, health care, disability, life and unemployment insurance benefits provided by these plans. More equitable and humane ways of raising revenue exist than curtailing or eliminating these benefits. Moreover, cutbacks in privately funded benefits will certainly result in new revenue pressures on federally funded or assisted programs.

A second reason for the restrictive legislative trend may be the instances of reported abuse—for example, doctors and other professionals arranging for yachts to be contributed to a purported benefit plan. To the extent such abuses actually exist, the coordinating committee has no interest in protecting them. However, we believe that actual abuses must first be identified, and that any remedy must be carefully tailored in order to excise only the abuse situation. Abuse surgery that cuts deeply into healthy tissue—for example the recent VEBA legislation—has already worked unnecessary and unfair hardship on participants in legitimate benefit plans.

In this connection, we are aware of no abuse in collectively bargained plans, and no such abuse has been reported. It has long been established that the very nature of the collective bargaining process—where the employer and the employee have a healthy adversity of economic interest—precludes the kinds of abuses that may exist elsewhere. Apparent abuses in one sector should not be used as a smokescreen for revenue-motivated cuts in a nonabusive area.

In this regard, we note that the House and Senate Labor committees have a familiarity and expertise on collective bargaining issues that is not shared by all members of the tax-writing committees. As a matter of fact, just a little earlier Congressman Stark mentioned that you are not considering the social policy problems, and I submit that somebody should. We believe that their effective exclusion from the legislative consideration of these issues has produced many unfortunate results, and should not continue.

A third rationale sometimes advanced for restrictions—for example the proposed tax cap on health care benefits—is supposedly grounded in principles of efficiency and cost containment. Extend the incentive to a flat dollar amount, the theory goes, and actual health care costs will magically shrink to stay within the limits.

This is, of course, pure pipe dream. The actual result would be the taxation of medical benefits for any middle- and low-income workers. In this respect, cost containment is nothing more than a pleasant euphemism for the imposition of taxes on health care benefits programs.

Moreover, the efficiency and cost-containment arguments have generally ignored the substantial, historical contributions of collectively bargained plans in these areas. These plans pioneered experimentation with health care delivery systems, such as HMO's, designed to provide care efficiently and at low cost.

In addition to curtailment of current tax incentives, the imposition of new taxes—FICA taxes, for example—is apparently now open for discussion. Any enlargement of the FICA tax base, through inclusion of such essential employee benefits as pension and health insurance, would, in our view, be a regressive and highly inequitable step. Many now receiving these benefits are among those least able to pay additional taxes.

Mr. Chairman, the 73 million workers covered under pension and health insurance plans represent a substantial constituency that must be taken into account. The taxation of benefit programs may appear to constitute a low-visibility/no-constituency issue at the present time. Plan participants tend to take these benefits for granted. Our experience has been, however, that when the change actually takes effect, participants become very vocal. I expect, Mr. Chairman, that you have observed this phenomenon yourself.

In closing, our fundamental belief is that the private sector plays an essential role, and is often more efficient and cost-effective than government programs, in providing health care and other essential benefits. The relatively modest tax incentives set forth in current law are an essential element to the viability of the private benefits system, as currently in effect.

As a matter of fact, if you took away the income from the tax revenue you expect to receive, you may not, because the funds may just not be there any longer. We look forward to the continuation, through the collective-bargaining process, of the health, welfare and retirement benefits on which our members so strongly depend.

Thank you very much for the opportunity to make our views known.

[The following statement was subsequently received:]

STATEMENT OF ROBERT A. GEORGINE, CHAIRMAN, NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS

My name is Robert A. Georgine, and I appear here today in my capacity as Chairman of the National Coordinating Committee for Multiemployer Plans.

The Coordinating Committee was organized, shortly after the passage of ERISA in 1974, in order to represent the interests of the more than eight million working men and women, and their families, who are covered by multiemployer plans. The Committee's affiliates include more than 140 pension funds, health and welfare funds, and related international unions.

Messrs. Chairmen, the NCCMP and its affiliates are deeply concerned about the continuing viability of collectively bargained employee benefit plans. These plans provide a wide range of essential benefits to workers who generally could not otherwise afford them, and thus serve a number of important public policies.

Nonetheless, a disturbing trend appears to be developing to curtail the federal tax incentives that have played a key role in the development of such benefit funds. Most recently, the Deficit Reduction Act of 1984 imposed new limits on contribution deductibility and subjected the earnings of employee benefit funds to new taxes on so-called unrelated business taxable income. That Act also repealed the estate tax exclusion for benefits paid from pension plans. Before that, the TEFRA legislation subjected pension benefits to withholding taxes and imposed other restrictions and burdens on employee benefit plans. There have been several major efforts, so far unsuccessful, to impose a "cap" on health care deductions or, alternatively, to include a portion of an employer's payments for health care in the income of the beneficiary. Numerous other examples might be cited to illustrate this trend.

Several factors appear responsible. First, the continuing federal deficits have created intense revenue pressures. Reducing the tax-favored status of employee benefits appeals to some as a low-visibility way to generate additional revenues. In our view, however, this nation cannot justify any attempt to balance the federal budget on the backs of the working men and women of this country. Our workers and their families depend on the retirement, health care, disability, life and unemployment insurance benefits provided by these plans. More equitable and humane ways of raising revenue exist than curtailing or eliminating these benefits.

Moreover, attempting to raise revenues in this manner is likely to be counterproductive. The curtailment of supplementary unemployment benefits, for example, would likely impose substantial additional pressures on federally funded or assisted welfare and unemployment programs. Cutbacks in the provision of pension benefits would create even more obvious participant needs. The loss of such benefits would also likely result in significant grassroots pressure for new programs involving direct federal spending. Existing federal tax incentives provide an efficient cost-effective incentive for the provision of these essential benefits by the private sector. Substantial curtailment of these incentives would represent short-sighted and ineffective economic planning.

A second reason for the restrictive legislative trend may be the instances of reported abuse—for example, doctors and other professionals arranging for yachts to be contributed to a purported benefit plan. To the extent such abuses actually exist, the Coordinating Committee has no interest in protecting them. However, we believe that actual abuses must first be identified, and that any remedy must be carefully tailored in order to excise only the abuse situation. Abuse surgery that cuts deeply into healthy tissue, for example the recent VEBA legislation, has already worked unnecessary and unfair hardship on participants in legitimate benefit plans.

In this connection, we are aware of no abuse in collectively bargained plans, and no such abuse has been reported. It has long been established that the very nature of the collective bargaining process—where the employer and the employee have a healthy adversity of economic interest—precludes the kinds of abuses that may exist elsewhere. All other things being equal, an employer's economic interest does not lie in making excessive contributions to employee benefit plans. While contributions are in the employee's interest, employees generally want contributions limited to what is necessary to fund the benefit involved. A dollar in additional employer contribution generally means a dollar less in wages. Moreover, multiemployer plans are jointly trusteed, so that this healthy adversity is reflected in the administration of such plans. Finally, collectively bargained plans do not selectively provide benefits to owners or highly compensated individuals, thereby posing discrimination problems, as is generally recognized by the anti-discrimination provisions of the International Revenue Code.

Thus, in our view, the perception of abuse or abuse potential offers no justification for new restrictions, tax or otherwise, on collectively bargained benefit plans.

Apparent abuses in one sector should not be used as a smokescreen for revenue-motivated cuts in a nonabusive area. In this regard, we note that the House and Senate Labor committees have a familiarity and expertise on collective bargaining issues that are not shared by all members of the tax-writing committees. We believe that their effective exclusion from the legislative consideration of these issues has produced many unfortunate results, and should not continue.

A third rationale sometimes advanced for restrictions—for example the proposed "tax cap" on health care benefits—is supposedly grounded in principles of efficiency and cost containment. Extend the incentive to a flat dollar amount, the theory goes, and actual health care costs will magically shrink to stay within the limits. Lower health care costs would benefit everyone (except perhaps the health care providers), and important social policy and federal revenue considerations would thereby be served.

This is, of course, pure pipe dream. The actual result would be the taxation of medical benefits for many middle- and low-income workers. Had the $175 per month "cap" proposed last year actually been adopted, one study conservatively estimates the following: 35 percent of the union-represented employees covered by multiemployer plans would have been subject to an average of $145 per year in additional tax. Some employees in the study would have owed nearly $500 in additional tax. In this respect, "cost containment" is nothing more than a pleasant euphemism for the imposition of taxes on health care benefits programs.

Moreover, the efficiency and cost-containment arguments have generally ignored the substantial, historical contributions of collectively bargained plans in these areas. Such plans pioneered experimentation with health care delivery systems designed to provide care efficiently and at low cost. These plans were among the first to utilize Health Maintenance Organizations, second opinions on the necessity for surgery, and dental clinics. This experimentation has continued outside the health care arena, as our plans' experience with legal services programs amply demonstrates.

In summary, then, the Coodinating Committee believes that any reappraisal of the tax incentives presently afforded to employee benefit plans should not lose sight of the central facts. First, such plans—particularly collectively bargained plans—have proven to be overwhelmingly successful arrangements for the private sector provision of essential benefits. Many of those for whom such benefits are provided have totally inadequate personal resources, and would otherwise fall back on the public sector. Efforts to improve on a system that is working so efficiently may well prove counterproductive.

Second, any so-called "reform" measures must be carefully directed, so as to cover only instances of actual abuse. Such measures should not result in restrictions on plans, like collectively bargained plans, where the perceived abuse cannot exist.

Finally, questions of revenue loss, efficiency and cost containment must be considered in the proper context. Historically, collectively bargained plans have been innovative leaders and experimenters in providing benefits efficiently and at low cost. Moreover, the "savings" from curtailment of tax incentives in this area may well be illusory, as plan participants will necessarily look to alternate sources—primarily federally funded benefit programs.

Messrs. Chairman, with the foregoing as prologue, I would like to address some of the specific questions posed by the Subcomitttees.

In their August 29, 1984 press release, the Subcommittees asked for information on the prevalance of fringe benefits (percentage of work force covered) and the percentage of total compensation that these benefits represent. As to prevalence—pension, health, and disability coverage is virtually universal for workers covered by collective bargaining agreements in industries with multiemployer plans. These industries include construction, entertainment, the needle trades, retail workers, maritime and trucking. Where other benefits, *e.g.*, supplemental unemployment assistance or severance pay, have been bargained for, they are also provided on a universal basis.

In general, multiemployer plan benefits are nondiscriminatory not only as to coverage but also as to benefit levels. Even pension benefits generally bear no relationship to position or rate of compensation, but rather are ususally based on length of service alone and do not increase with higher compensation levels. The total absence of discrimination in the collectively-bargained context is specifically recognized by the Internal Revenue Code. Id. at § 413(b).

As to the percentage of compensation accounted for by fringe benefits, we estimate that the appropriate figure in industries with multiemployer plans is between 15 and 25 percent. In our industries, at least, true fringe benefits still account for only a small fraction of total compensation. The big growth in benefit coverage in our industries occurred in the mid- to late-fifties. In the sixties, growth in the number and kinds of plans was slow, but contributions to and the benefits of such plans increased somewhat. In the seventies and eighties, the legislative atmosphere, including ERISA and subsequent legislation, has made providing benefits more complicated and less attractive. We expect that the future will also depend to a great extent on the legislative atmosphere. Without change in applicable law, we would expect the basic benefit structure and level to remain relatively unchanged. Curtailment or expansion of tax-favored treatment, on the other hand, would likely produce a parallel cutailment or expansion of benefits.

In you examination of percentages cited to you by others, we caution you to determine the basis on which the computations were made. Where, for example, FICA, FUTA, vacation and holiday costs are counted as "fringe benefits," the percentage will be higher than where they are not. Moreover, some apparent "growth" in fringe benefit costs has nothing to do with voluntary behavior by employers or employees, or any desire to convert wage income into tax-favored compensation. For example, the more rapid funding of pension benefits required by ERISA results in higher *current* costs for the same ultimate pension benefit. Health care cost increases may produce similar "growth" in the percentage of compensation accounted for by health benefits without any real expansion in what participants actually receive. To the extent Social Security were counted as a "fringe benefit," FICA tax increases would also have produced such an artificial growth. In summary, the Committees should be careful not to jump to unwarranted conclusions from numbers cited to them concerning the percentage of total compensation accounted for by fringe benefits.

The Subcommittees' press release also asks how the "tax-favored treatment" of various benefits affects the selection decisions in structuring a compensation package. To answer this question, different types of "tax-favoring,"—*i.e.*, tax-free receipt of benefits on the one hand and current deductibility and deferral on the other—must be distinguished. Current deductibility by employers (whether or not contemporaneously includible in employee income) is essential if the selection is to be tax neutral from the employer's point of view. Compensation that appears in the employee's pay envelope is clearly deductible, and employers will likely resist compensating in some other form that involves a current expenditure with out a current deduction. (Until the recent VEBA legislation, there was no such concern regarding multiemployer plan benefits. Unfortunately, this concern is now all too real.)

Similarly, employees would likely resist being compensated in a form that generated current taxability even though there were no benefit currently in hand. The likely reaction will be: "If I'm going to be taxed on some benefit now, I want to receive the benefit now also, in cash or otherwise." By their very nature, of course, benefits like retirement income cannot be provided on a current basis to active employees. Health care coverage presents a similar situation. For this reason, some asyymetry in taxation, *i.e.*, deferral, may be necessary to preserve tax neutrality in the selection between benefits and pure wage compensation.

The press release also asks about the effect of including nontaxable benefits in the Social Security wage base. In the Coordinating Committee's view, any nonwage-based expansion of the FICA tax base is intrinsically regressive and inequitable. Subjecting health care coverage to FICA tax, for example, would clearly hit low and middle-income workers much harder than others. First, health coverage costs are not generally dependent on income, so equivalent additional amounts would potentially be subject to tax, regardless of income level. Since FICA taxes are assessed as a fixed percentage, the additional tax would represent a larger percentage of the lower-paid worker's income.

Second, the income of the most highly compensated already exceeds the maximum subject to tax. Thus, subjecting health coverage costs to FICA tax would, for these individuals, result in no additional taxes.

Third, benefits like health care coverage involve no cash income to the recipient. Thus, workers would have additional taxes withheld from their take-home pay without receipt of any additional moneys with which to pay the taxes. The NCCMP opposes any federally-mandated pay cut of this sort.

In brief response to the other questions posed by the press release, the Coordinating Committee opposes any new caps, excise taxes, or other limits on fundamental fringe benefits like pension, disability and health care coverage. In the collectively-bargained context, at least, the natural economies involved (*e.g.*, the worker's natural desire to receive cash compensation and the employer's natural inclination not to provide additional *gratuitous* compensation in any form) provide their own effective limits on benefits.

As to the relationship between privately-provided fringe benefits and social programs provided by government agencies, the fundamental link is undeniable. Pension policy, for example, has been discussed for many years in the context of a "three-legged stool" supported by Social Security, private pension programs, and individual savings. If the balance between these three elements is altered, *e.g.*, by a curtailment of a tax-favored treatment of private pension programs, a compensating change elsewhere is clearly essential to prevent the stool from toppling. Social Security is the obvious possibility. Similarly, cuts in private health care coverage will clearly increase Medicare/Medicaid costs, and will lead to new and vociferous calls for additional federal coverage.

Messrs. Chairmen, the seventy-three million workers covered under health insurance plans represent a substantial constituency that must be taken into account. The taxation of benefit programs may well constitute a low-visibility/no-constituency issue now. Plan participants tend to take these benefits for granted, and do not generally scrutinize the Daily Tax Reporter or other public accounts of proposed changes in this area. Our experience has been, however, that when the change actually takes effect, participants become *very* vocal. I expect that you have observed this phenomenon yourselves.

In closing, our fundamental belief is that the private sector plays an essential role, and is often more efficient and cost-effective than government programs, in providing health care and other essential benefits. The relatively modest tax incentives set forth in current law are an essential element to the viability of the private benefits system, as currently in effect. We look forward to the continuation, through the collective bargaining process, of the health, welfare and retirement benefits on which our members so strongly depend.

Thank you very much for the opportunity to make our views known.

Chairman PICKLE. Thank you, Mr. Georgine.

I notice that you keep referring to the fact that there ought to be an involvement of a collective bargaining nature more and more in these negotiations rather than the tax aspect of it. On page 3 you state that you are aware of "no abuse in collectively bargained plans and no abuse has been reported." Well, we in this committee are not contesting that there are or there aren't abuses. We haven't said there have been abuses.

We are not going to proceed from a basis that we are claiming that there have been abuses. Perhaps there have been with some of the higher paid plans, such as you mentioned with the doctor, but whether there have or haven't been abuses that is not the question. What we are concerned about is not who has got the expertise so much from this committee's standpoint, but what is the extent of the growth of these programs.

Disabuse yourself that we are trying to balance the social needs with the tax aspect. The only thing we can consider is the tax. We don't have to take a position about whether the collective-bargaining process ought to be or whether it should be involved with the Education and Labor Committee. That may or may not be, but this committee is concerned about the tax aspect and the growth, and we are not going to get to chasing that rabbit, that we are going to raise some money in order to give it to others.

There may not be any abuses in the collective bargaining system, and we can recognize that, but theoretically, through collective bargaining, you could continue to give collective bargaining that you think is a good program and it could get higher than a cat's back.

Just collective bargaining itself is not the answer. It can be helpful, and you do have expertise there, but we are trying to concern ourselves now with the growth of these benefits.

Have they grown enough or too much; will they continue to grow; and should the Congress try to concern itself with some kind of a standard in the growth of them. That is what we are trying to get at, and not whether we are trying to recommend that you are or are not having some kind of abuse or you have more collective bargaining. That may be.

Mr. GEORGINE. I made that comment with regard to the recent VEBA legislation, but I would say that there should be some concern if the taxes that are going to be imposed are really in effect hurting those people who can least afford to pay additional taxes. That is the point. The point is that what you are doing really is you are imposing a pay cut on those people.

Chairman PICKLE. If we don't have concern about it, there is a vast area of people out there, 15 to 20 percent of them, who get none of these benefits. That is an inequity, and they are usually the lower paid worker. They are not in unions, many of them, but they are terribly hurt, and they think this is unfair, and our committee recognized that they do have a valid point there.

I want to ask you another question, because the question is before us now with respect to educational benefits. Do you, does your organization think that we should renew, for instance, the educational benefit program?

Mr. GEORGINE. We support that, although it doesn't affect in large measure the members that I represent, which are building and construction trade workers. But we do support that, yes, sir.

Chairman PICKLE. If you support it, and it has been on the books previously by statutory exemption, and the Congress is now faced with the question do we renew it; if we renew it, should we withhold FICA and/or FUTA?

Mr. GEORGINE. I think not.

Chairman PICKLE. On the one hand you want the benefits to go to the employees, but you don't want him to pay any tax on them, not even withholding or FICA and FUTA; is that correct?

Mr. GEORGINE. That is right.

Chairman PICKLE. Then you want it both ways, don't you?

Mr. GEORGINE. Not really. What I am saying is that these programs would not be in effect if Congress hadn't passed legislation that would encourage them. We didn't begin developing pension funds and health and welfare programs and prepaid legal insurance and all of those kinds of benefits for workers until laws had been passed that made it permissible to do so.

Chairman PICKLE. The fact that a law is passed and it didn't withhold doesn't mean that it has to stay in forever. As these programs continue and as they grow, and as they multiply, we have to ask ourselves, do we or do we not also have a withholding of FICA and FUTA, not that it has been on the books previously.

Admittedly, when these laws were on the books previously, the benefits weren't taxed. I think this committee is willing to now review them, but we are asking, if so, since they are an item of value, it should be a small matter about withholding. It is a relatively small matter but it is terribly important with respect to being a symbolic position.

Mr. GEORGINE. We disagree on that, that it is relatively small. I don't believe it is relatively small to those workers who are making such little money that this would be an additional tax and a real deduction from their income.

Chairman **Pickle**. They all don't make a little money. It is not just a little thing. They could get two or three thousand dollars benefits a year and you say no withholding on it.

Mr. **Georgine**. Many don't get the benefit.

Chairman **Pickle**. But many of them do. Many of them are certainly able to pay it.

Mr. **Georgine**. That is the purpose of the system, to augment what they do not get right now.

Chairman **Pickle**. If you gave somebody a $2,000 benefit, and there is a withholding of let's say 7 percent, that would mean each employee even then would have to pay approximately $10 or $12 a month. Do you think that is onerous to that employee? They get $2,000 worth of free benefits and are not willing to pay $10 or $12 a month for that?

Mr. **Georgine**. In that one year that they get those benefits, I guess you could say not, but the fact of the matter is that they may or may not get benefits in any given year. That is the way the system is designed. The system is designed so that people who cannot afford hospitalization will have some way of getting it when the occasion occurs.

Chairman **Pickle**. We understand that, and we want them to have it. I think the Congress takes the position that this is a good thing and that perhaps it is worthwhile because that improves the employee's skill. But as that employee gets a very definite value, then we say that we ought to perhaps include that in FICA.

You realize in the process of doing that, that employee gets a lower wage base for a period of 1, 2, 3, 4 years, however long it lasts, however many times it is going to occur. Because these benefits are not included for tax purposes, by the time the employee gets Social Security benefits, they are a considerably less sum. Do you admit that?

Well, it is a fact, and you can ask counsel later, but it is a fact, and we have to look at that also. It seems to me I would think that it would be equally of an advantageous nature to the unions or to the employee to include that in the wage base, so that in the history, in the long term, they get more of a return.

Mr. **Georgine**. Whether they will get more in the long term is really speculative and a long way down the road.

Chairman **Pickle**. Nobody takes those wages and credits away from him. All he has to do is just stay alive and he will get them.

I thank you. I am not arguing the question. It just seemed to me sometimes that in many respects the employees and the unions want these benefits and they are good, helpful and they fit into our overall program and training, unemployment trying to improve the status of that individual and his ability to earn, but they don't want to pay anything for it.

I won't make the success or failure of Social Security an important factor, but it is something we must look at and be honest about it on both sides. That is what we are trying to do. We will continue to work with you on this and be glad to deal with you further.

Thank you very much.

Mr. **Georgine**. Thank you, Mr. Chairman.

Chairman PICKLE. Now the Chair will recognize as our last panel Mr. Ray Denison; Mr. Mike Tiner; and Mr. Alan Reuther.

Thank you, gentlemen. We have Mr. Ray Denison, director, department of legislation, American Federation of Labor and Congress of Industrial Organization, AFL-CIO. Mr. Mike Tiner is assistant director of government affairs, United Food and Commercial Workers International Union. Mr. Alan Reuther, assistant general counsel, International Union, United Automobile, Aerospace and Agricultural Implement Workers of America. You have got them all.

First we will be glad to hear from Mr. Denison.

STATEMENT OF RAY DENISON, DIRECTOR, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR & CONGRESS OF INDUSTRIAL ORGANIZATIONS, ACCOMPANIED BY ARNOLD CANTOR, ASSOCIATE DIRECTOR, DEPARTMENT OF ECONOMIC RESEARCH

Mr. DENISON. Thank you, Mr. Chairman. I am accompanied this afternoon by Arnold Cantor, associate director of our economic research department, AFL-CIO.

The AFL-CIO is pleased to present its views on the tax treatment of employer-paid fringe benefits. We are especially pleased that the purpose of these hearings is not to draft a particular legislative proposal but to conduct a comprehensive examination and achieve an understanding of the entire issue of tax-exempt fringe benefits.

Chairman PICKLE. Mr. Denison, that is why we haven't submitted any legislation, no specific legislation. We are looking at the broad picture of it. You are correct, and I am glad you mentioned that.

Mr. DENISON. Thank you.

We appreciate the critical need for measures to reduce the deficit and make the Nation's tax structure more efficient and productive. But there are far better means to attain these goals than increasing the taxes of working people and jeopardizing benefits and protections that are essential to their welfare and that of their families. The revenue-raising measures endorsed by the AFL-CIO are detailed in attachment II on pages 10 through 14.

In December 1979, the AFL-CIO convention set forth general standards with respect to the taxation of fringe benefits and specifically urged the continuation of present statutes, which expressly grant tax exemptions under limited circumstances for benefits, such as qualified pension plans, group life insurance, health benefits, group legal services, employee death benefits, educational assistance programs, and moving expenses.

The Congress, in the just enacted 1984 tax legislation, did much to end the confusion and uncertainty over the tax status of fringe benefits. As a result of the 1981 legislation, many fringe benefits achieved through collective bargaining have now been stabilized. If they remain so, they will have eliminated the possibility of becoming serious issues in future contract discussions. Unfortunately, in the legislative process a number of hard fought gains of workers were unfairly and unnecessarily jeopardized.

Many Americans will suffer as a result of the provisions regarding voluntary employees' beneficiary associations [VEBA's], supplemental unemployment compensation benefit trusts [SUB's], group legal services organizations, certain pension plans and the termination of the exclusion from income of benefits provided employees under an educational assistance program.

In the fringe benefit group under consideration at this hearing, however, the stakes are much higher. At risk are widely used programs that fulfill major, demonstrable needs and social purposes that affect the great majority of working Americans.

Health insurance, pensions, day care, education programs, prepaid legal plans have evolved over many years and have been subjected to the checks and balances of the legislative process as well as the collective bargaining process. They have been created to achieve specific goals. They were won through tough decisions based on economics and equity.

In examining these benefits Congress is not dealing with frivolous "perks" or gimmicks to shelter income, generate phony losses or otherwise reduce the taxes of a privileged few. These measures are for the most part longstanding economic buttresses of the tax code, that affect millions of workers and are widely distributed.

Most significant is the fact that, in order to qualify for tax exclusion, the plans must comply with stringent rules that prohibit discrimination in favor of owners, officers, shareholders and highly compensated employees and generally contain limitations and constraints to assure that the intended beneficiaries and purposes are served.

That test in our view distinguishes these provisions from so many other so-called tax "preferences" which by design or effect primarily benefit a privileged few and provide no assurance that their stated purpose will be served.

Private employer paid pension plans, for example cover the vast majority of the workforce. The latest—1983—Bureau of Labor Statistics study of employee benefits found that 82 percent were covered by a pension plan—attachment I, page 9.

The 1983 BLS study also found that 96 percent of all workers are covered by health insurance plans and that 93 percent had coverage for their dependents. Over the past several years employers have transferred increasing health care costs to their employees—a trend that runs directly counter to the assertion that the tax structure unduly influences the growth of such plans.

This is not to suggest that present practices leave nothing to be desired nor that tax exclusion is a preferred route to attainment of social goals. It does, however, clearly suggest that:

Any revenue that Congress attains from taxing fringes will be directly and exclusively taken out of the pockets of working people, and

Any changes in relative tax burdens that may come about will be strictly the result of shifting and rearranging the tax liabilities of working people.

It seems to us that, at best, Mr. Chairman, taxing these "statutory" fringes adds up to taxing the same group of people even more.

We are also quite concerned that efforts will be made, in the search for revenue, to deal with problems that should not and cannot be solved by the tax code. The administration's proposal to place annual limits per family and per individual on the amount of tax-free contributions employers make to worker health insurance plans is a prime example of misuse of the tax structure.

The claim is that this will make workers more cost-conscious and the rise in health care costs will be blunted, and, at the same time, revenue will be raised. Eliminating the tax-free status of employer health care contributions would force a major reexamination of these plans with the potential effect of forcing millions of low and middle income families to lose protection against the high cost of getting sick.

Those who advocate eliminating tax exclusion for employer health insurance contributions or placing a cap on tax-free employer contributions grossly overstate the potential for such proposals to reduce health care inflation. The underlying premise of their argument is that an employee health tax would give consumers an incentive to reduce coverage which, in turn, would force a reduction in demand for health care; and doctors, hospitals and the health care "providers" would reduce prices.

This is a so-called "market solution" to our health care crisis. Unfortunately, the health care market does not function like other "markets." For example, a recent article in the "Journal of Human Resources" used data from the Department of Health and Human Services to conclude that health care expenditures which are initiated by physicians represented 89 percent of total health care expenditures.

In other words, unlike other markets where consumers make their own purchasing decisions, in health care physicians function as purchasing agents for patients. Physicians decide when patients need to go into the hospital, how long they stay, and what tests and medications they receive while they are there. We believe it makes no sense to use a tax penalty to encourage patients to act in an area over which they have little control.

Moreover, the most likely effect of scaled back benefits will be loss of coverage for preventive care, outpatient diagnostic services, dental, eyeglasses and other benefits which save money. What would be left intact is coverage for hospital and surgical benefits which have been the major source of our health inflation problems and over which patients have very little control.

Attempts to tax employees on the deferred income value of employer contributions to qualified pension plans raises a huge array of issues. First, of course, is the fact that pension income is taxed when received by the employees and their beneficiaries. And, to qualify, plans must comply with elaborate minimum participation standards and other rules that forbid contibutions or benefits discriminating in favor of the employer's officers, shareholders, and other highly compensated employees.

Moreover, the entire legislative history in the area of qualified pension plans has been one of concern with the level and security of employee benefits. On this point this committee in 1974 stated (H. Rep. No. 93-779):

> * * * clearly the greatest single protection for rank and file employees during this time has been the Internal Revenue Service's administration of the provisions denying any special tax treatment in favor of employees who are officers, shareholders,

supervisors, or highly compensated employees. The thrust of this provision is to require broader substantial participation in the plans than would be provided but for the Service's administration of the statute.

Other concerns that come to mind surround the fact that since workers do not have control over the use of pension contributions it's hard to envision a fair method of considering the contributions as taxable income. For example:

Many workers never get vesting rights to the money which was placed in the pension fund in their name. Thus people would be taxed on money that they will never use.

Although about 50 percent of all private sector pension funds are for union workers, no union fully controls the fund and only 10–15 percent jointly control their funds. Thus workers, both union and nonunion in the public and private sector, would be taxed for pension contributions as if they were recovering benefits that were equivalent to their paychecks. By taxing pension contributions, workers would pay taxes on money over which they have almost no influence.

Many pension funds are not fully funded. Would workers be taxed on the benefits they have accrued or on the amount which the employer has actrually contributed?

Frequently, there are larger year-to-year fluctuations in employer contributions based on changing actuarial assumptions. How would this affect the taxes of individual workers?

Recent hearings before the Subcommittee on Labor of the Senate Committee on Labor and Human Resources has shed light on the problem of corporations terminating healthy pensions to "recapture excess assets." Would workers be given tax credits when this happened?

The interest in taxing employer contributions to workers' pension plans is particularly difficult to understand in the light of the many recent attempts and actions to widen the exclusions for Individual Retirement Accounts and to expand plans for the self-employed. These measures contain few of the constraints and assurances against abuse that apply to qualified employee plans and have a proven track record of reducing the tax burdens of wealthier individuals while doing little or nothing to add to the Nation's "savings" rate.

With regard to group legal services plans, we continue to urge that the Congress adopt S. 2080, a bill to make permanent section 120 of the Internal Revenue Code and thus continue to encourage qualified group legal service plans. We believe that current tax treatment of qualified group legal service plans has helped in making such services available to many who would otherwise be denied such protection at minimal cost. There is no evidence that such plans have been abused, exploited as tax shelters, or led to inequities or discriminatory practices

Stringent limits also preclude abuse in the dependent care assistance exclusion, the revenue loss is minimal and we believe it is in the national interest to encourage the growth and development of such programs.

We also believe Congress was wrong allowing expiration of the statutory exclusion from income of benefits provided employees and laid-off workers under an educational assistance program.

Again, there is no evidence of abuse and the limitations and conditions needed to qualify, assure again unintended benefits or actions contrary to congressional intent. And programs under these plans have helped employees and laid-off workers receive essential training. Also the expiration of these measures will result in back-tax payment requirements for ambitious low-level people trying to get ahead through employer aid for continuing education.

We do not wish to be negative nor do we feel that Congress can afford to overlook any opportunity to make the tax structure fairer and better equipped to meet the Nation's needs.

Nevertheless, the fact that the root cause of the problem is the 1981 tax cut cannot be put aside. That act decimated the Treasury and shifted much of the remaining burden onto the backs of working Americans.

The 1982 and 1984 tax measures raised some revenue through curbing abuses and trimming some loopholes. However, substantial reliance was on excise taxes, taxing employee benefits and other measures which hurt working people. At the same time measures such as the withholding of taxes on interest, dividends, and foreign portfolio income were defeated, corporations were given a $12 billion windfall by the forgiveness of taxes which were "deferred" under the Domestic International Sales Corporation (DISC) program and the capital gains holding period was cut in half, widening the loophole responsible for most of the inequities in the individual income tax.

We believe this pattern of heaping more and more of the tax burden on working people must be reversed. We urge you to recognize that any revenue to be gained through taxing workers on their fringe benefits—particularly those in the areas of health, education, pensions, and similar social needs—would result in more injustice, not less. The list of alternative means to achieve both revenue and equity goals is a long one. We have appended beginning on page 10 for your consideration the AFL-CIO's list of recommendations.

Thank you.

[The prepared statement follows:]

STATEMENT OF RAY DENISON, DIRECTOR, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR & CONGRESS OF INDUSTRIAL ORGANIZATIONS

The AFL-CIO is pleased to present its views on the tax treatment of employer paid fringe benefits. We are especially pleased that the purpose of these hearings is not to draft a particular legislative proposal but to conduct a comprehensive examination and achieve an understanding of the entire issue of tax exempt fringe benefits. We appreciate the critical need for measures to reduce the deficit and make the nation's tax structure more efficient and productive. But, there are far better means to attain these goals than increasing the taxes of working people and jeopardizing benefits and protections that are essential to their welfare and that of their families. The revenue-raising measures endorsed by the AFL-CIO are detailed in Attachment II on pages 10 through 14.

In December 1979, the AFL-CIO Convention set forth general standards with respect to the taxation of fringe benefits and specifically urged the continuation of present statutes, which expressly grant tax exemptions under limited circumstances for benefits, such as qualified pension plans, group life insurance, health benefits, group legal services, employee death benefits, educational assistance programs, and moving expenses.

The Congress, in the just enacted 1984 tax legislation did much to end the confusion and uncertainty over the tax status of fringe benefits. As a result of the 1981 legislation, many fringe benefits achieved through collective bargaining have now been stabilized. If they remain so, they will have eliminated the possibility of becoming serious issues in future contract discussions. Unfortunately, in the legislative process a number of hard fought gains of workers were unfairly and unnecessarily jeopardized. Many Americans will suffer as a result of the provisions regarding voluntary employees' beneficiary associations (VEBAs), supplemental unemployment compensation benefit trusts (SUBs), group legal services organizations, certain pension plans and the termination of the exclusion from income of benefits provided employees under an educational assistance program.

In the fringe benefit group under consideration at this hearing however, the stakes are much higher. At risk are widely used programs that fulfill major, demonstrable needs and social purposes that affect the great majority of working Americans.

Health insurance, pensions, day care, education programs, prepaid legal plans have evolved over many years and have been subjected to the checks and balances of the legislative process as well as the collective bargaining process. They've been created to achieve specific social goals. They were won through tough decisions based on economics and equity.

In examining these benefits Congress is not dealing with frivolous "perks" or gimmicks to shelter income, generate phony losses or otherwise reduced the taxes of a privileged few. These measures are for the most part long standing economic buttresses of the tax code, that affect millions of workers and are widely distributed.

Most significant, is the fact that, in order to qualify for tax exclusion, the plans must comply with stringent rules that prohibit discrimination in favor of owners, officers, shareholders and highly compensated employees and generally contain limitations and constraints to assure that the intended beneficiaries and purposes are served.

That test in our view distinguishes these provisions from so many other so-called tax "preferences" which by design or effect primarily benefit a privileged few and provide no assurance that their stated purpose will be served.

Private employer paid pension plans for example, cover the vast majority of the work force. The latest (1983) Bureau of Labor Statistics study of employee benefits found that 82 percent were covered by a pension plan (Attachment I, page 9).

The 1983 BLS study also found that 96 percent of all workers are covered by health insurance plans and that 93 percent had coverage for their dependents. Over the past several years employers have transferred increasing health care costs to their employees—a trend that runs directly counter to the assertion that the tax structure unduly influences the growth of such plans.

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It seems to us that, at best, Mr. Chairman, taxing these "statutory" fringes adds up to taxing the same group of people even more.

HEALTH CARE

We are also quite concerned that efforts will be made, in the search for revenue, to deal with problems that should not and cannot be solved by the tax code. The Administration's proposal to place annual limits per family and per individual on the amount of tax-free contributions employers make to worker health insurance plans is a prime example of misuse of the tax structure. The claim is that this will make workers more cost conscious and the rise in health care costs will be blunted, and, at the same time, revenue will be raised. Eliminating the tax-free status of employer health care contributions would force a major reexamination of these plans with the potential effect of forcing millions of low and middle income families to lose protection against the high cost of getting sick.

Those who advocate eliminating tax exclusion for employer health insurance contributions or placing a cap on tax-free employer contributions grossly overstate the potential for such proposals to reduce health care inflation. The underlying premise of their argument is that an employee health tax would give consumers an incentive to reduce coverage which, in turn, would force a reduction in demand for health care; and doctors, hospitals and the health care "providers" would reduce prices.

This is a so-called "market solution" to our health care crisis. Unfortunately, the health care market does not function like other "markets." For example, a recent article in the Journal of Human Resources used date from the Department of Health and Human Services to conclude that health care expenditures which were initiated by physicians represented 89 percent of total health care expenditures.

In other words, unlike other markets where consumers make their own purchasing decisions, in health care physicians function as purchasing agents for patients. Physicians decide when patients need to go into the hospital, how long they stay, and what tests and medications they receive while they are there. We believe it makes no sense to use a tax penalty to encourage patients to act in an area over which they have little control.

Moreover, the most likely effect of scaled back benefits will be loss of coverage for preventive care, outpatient diagnostic services, dental, eyeglasses and other benefits which save money. What would be left intact is coverage for hospital and surgical benefits which have been the major source of our health inflation problems and over which patients have very little control.

PENSIONS

Attempts to tax employees on the deferred income value of employer contributions to qualified pension plans raises a huge array of issues. First of course, is the fact that pension income *is* taxed when received by the employees and their beneficiaries. And, to qualify, plans must comply with elaborate minimum participation standards and other rules that forbid contributions or benefits discriminating in favor of the employer's officers, shareholders, and other highly compensated employees. Moreover, the entire legislative history in the area of qualified pension plans has been one of concern with the level and security of employee benefits. On this point this Committee in 1974 stated (H. Rep. No. 93-779):

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Other concerns that come to mind surround the fact that since workers do not have control over the use of pension contributions it's hard to envision a fair method of considering the contributions as taxable income. For example:

Many workers never get vesting rights to the money which was placed in the pension fund in their name. Thus people would be taxed on money that they will never see.

Although about 50 percent of all private sector pension funds are for union workers, no union fully controls the fund and only 10-15 percent jointly control their funds. Thus, workers, both union and nonunion in the public and private sector, would be taxed for pension contributions as if they were receiving benefits that were equivalent to their paychecks. By taxing pension contributions workers would pay taxes on money over which they have almost no influence.

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The interest in taxing employer contributions to workers' pension plans is particularly difficult to understand in the light of the many recent attempts and actions to widen the exclusions for Individual Retirement Accounts and to expand plans for the self-employed. These measures contain few of the constraints and assurances against abuse that apply to qualified employee plans and have a proven track record of reducing the tax burdens of wealthier individuals while doing little or nothing to add to the nation's "savings" rate.

OTHER PROGRAM OF CONCERN TO WORKERS

With regard to group legal services plans, we continue to urge that the Congress adopt S. 2080, a bill to make permanent Section 120 of the Internal Revenue Code and thus continue to encourage qualified group legal service plans. We believe that current tax treatment of qualified group legal service plans has helped in making such services available to many who would otherwise be denied such protection at minimal cost. There is no evidence that such plans have been abused, exploited as tax shelters, or led to inequities or discriminatory practices.

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We do not wish to be negative nor do we feel that Congress can afford to overlook any opportunity to make the tax structure fairer and better equipped to meet the nation's needs.

Nevertheless the fact that the root cause of the problem is the 1981 tax cut cannot be put aside. That act decimated the Treasury and shifted much of the remaining burden onto the backs of working Americans.

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We believe this pattern of heaping more and more of the tax burden on working people must be reversed. We urge you to recognize that any revenue to be gained through taxing workers on their fringe benefits—particularly those in the areas of health, education, pensions and similar social needs—would result in more injustice, not less. The list of alternative means to achieve both revenue and equity goals is a long one. We have appended beginning on page 10 for your consideration, the AFL-CIO's list of recommendations.

ATTACHMENT I

FULL-TIME EMPLOYEES BY PARTICIPATION [1] IN EMPLOYEE BENEFIT PROGRAMS, MEDIUM AND LARGE FIRMS, 1983

[Amounts in percent]

Employee benefit program	All employees	Professional and administrative	Technical and clerical employees	Production employees
Sickness and accident insurance	49	29	34	67
Long-term disability insurance	45	66	58	28
Health insurance for employees	96	98	95	96
Health insurance for dependents	93	95	91	92
Life insurance	96	97	95	95
Retirement pension	82	86	84	79

[1] Participation is defined as coverage by a time off, insurance, or pension plan. Employees subject to a minimum service requirement before they are eligible for a benefit are counted as participants even if they have not met the requirement at the time of the survey. If employees are required to pay part of the cost of a benefit, only those who elect the coverage and pay their share are counted as participants. Benefits for which the employee must pay the full premium are outside the scope of the survey. Only current employees are counted as participants; retirees are excluded even if participating in a benefit program.

Note.—This survey covers medium and large private sector nonagricultural establishments in the United States, excluding Alaska and Hawaii. Minimum firm size ranges from 50 to 250 employees depending on the industry covered. The number of employees included in this survey is about 55.6 million which is 54 percent of all employed, 81 percent of full-time employees, and 73 percent of private sector nonagricultural employees.

Source: "Employee Benefits in Medium and Large Firms, 1983". U.S. Department of Labor, Bureau of Labor Statistics, August 1984.

ATTACHMENT II

THE AFL-CIO TAX REFORM PROPOSALS

The AFL-CIO supports a major tax reform initiative based upon fairness and the need to raise enough revenues for the federal government to carry out its many very important responsibilities. For any tax reform proposal to be fair, income must be retained as the tax base, and the rate structure—as well as actual effective tax rates—must be progressive.

The AFL-CIO's tax reform proposal calls for the termination of loopholes that favor business and the rich, and the reversal of some of the more unfair and unwise features of the 1981 Tax Act.

Basically, we recommend the approach adopted in February, 1983, by the AFL-CIO Executive Council. That program, through a combination of measures addressed to the 1981 Act, and some fundamental reforms, would raise the needed revenues, and lead to a fairer tax code, capable of sustaining economic recovery.

A principal cause of the deficit crisis is the 1981 Tax Cut, and raising revenues requires a major revision of some of the worst features of the 1981 law.

We support a cap on the personal tax cut that would limit the third year of the tax cut to $700.

A key element of the AFL-CIO's tax justice program is repeal of the indexation provisions of the Economic Recovery Tax Act of 1981. Repeal of indexation will increase revenues by $6.2 billion in fiscal year 1985 and $16.7 billion in fiscal year 1986.

Without indexing, the system of progressive tax rates automatically serves as a contracyclical force, moderating excessive demand during inflationary periods and helping to sustain purchasing power during recessions. If indexing goes into effect, however, the tax structure will automatically adjust in a procyclical fashion, adding momentum to inflations and recessions. Moreover, the ability of government to use discretion in the conduct of tax policy would be severely curtailed by the linking of tax rates to the rate of inflation. Monetary policy would become an even more dominant factor in the economy.

Another tax loophole mistakely characterized as a savings incentive is the exemption from taxation of individual retirement accounts. The higher a taxpayer's income, the greater is the tax windfall this gimmick provides. To make the IRA somewhat more equitable, the tax benefit should be changed from an exclusion from gross income to a credit which would provide the same dollar benefit amount regardless of the taxpayer's bracket.

Another feature of the tax code high on our list is the 60 percent exclusion from income of capital gains. Combined with the lowering of the maximum tax rate to 50 percent by the 1981 Tax Law this exclusion reduces the maximum tax rate on capital gains to only 20 percent. This exclusion costs the Treasury $18 billion a year in revenues and primarily benefits the wealthy—with the top 5 percent of taxpayers getting 60 percent of the benefits. The 1984 law has now reduced the holding period for long term capital gains from one year to six months and will result in additional revenue losses. This new gimmick should be reversed.

The AFL-CIO supports restoring the capital gains exclusion to the 50 percent level that prevailed before 1979, and beginning in 1985, the exclusion should be phased out over a 5-year period, with adequate protection for homeowners. This would raise nearly $3 billion in FY 1975 and over $5.0 billion in FY 1986.

The federal tax system was tilted further in favor of the wealthy by the virtual elimination of the Estate and Gift Tax in 1981. The 1984 tax law delayed the reduction from 55 to 50 percent, in the top estate and gift tax rate that was scheduled for 1985. The 55 percent rate will remain in effect through 1987. When the rate cuts and increases in exemption enacted in 1981 are fully phased in, only 0.3 percent of all estates will be subject to estate taxes, and the liabilities of these few estates that are taxed will be substantially reduced.

The reduction of estate and gift taxes eliminates an important and equitable constraint on the accumulation and intergenerational transfer of vast fortunes. Equity considerations require effective taxation of accumulated wealth and the recent array of exemptions of capital from taxation makes this even more urgent.

Restoration of the estate and gift tax to its former structure, which allowed $250,000, or over half of the estate (whichever is greater) to be passed on to the surviving spouse tax free and provided generous credits for heirs would raise $3.7 billion in FY 1985, and $5.0 billion in FY 1986.

As a result of the business provisions of the 1981 Tax Act, the corporate income tax has been virtually eliminated. We call for reinstatement of the corporate income tax as a source of revenue, equity, and economic balance. Primarily because of the accelerated cost recovery (ACRS) provisions of the 1981 act, corporate tax revenues for the 1983 and 1984 budgets are estimated at only $35.3 and $64 billion, respectively. At these levels, corporate receipts will be only 5.9 percent of total 1983 budget receipts and 9.6 percent of anticipated 1984 revenue. In 1980, the ratio was 12.5 percent, and in 1970, it was 17 percent. In 1960—before the enactment of depreciation speed-ups, the investment tax credits, and rate reductions—the corporate income tax financed nearly 25 percent of the entire federal budget. If the corporate income tax were to bear the same share of the federal tax burden in 1984 as it did in 1980, receipts would be $20 billion higher. (See the attached chart illustrating the sources of federal revenues.)

We also support the restoration of a portion of lost corporate tax receipts by ending the tax subsidies that encourage the overseas operations of U.S.-based multinational corporations. These preferences have eroded the tax structure, destroyed American jobs, and spurred the outflow of U.S. capital, technology, and know-how. Specifically:

Foreign tax credits.—The present practice of allowing dollar-for-dollar credits against a multinational company's U.S. income tax liability is a loophole which encourages U.S. corporations to produce abroad. Foreign taxes should be deducted just like state taxes and other costs of doing business.

Deferrals.—The deferral privilege allows multinational corporations to defer U.S. income tax payments on the earnings of their foreign subsidiaries until such profits are brought home—which may never occur.

Foreign Sales Corp. (FSC).—Although the 1984 tax law terminated the Domestic International Sales Corporation (DISC) program, it replaced it with the new Foreign Sales Corporation (FSC) provisions, and it forgave the taxes on income that DISCs have been deferring for years. The Foreign Sales Corporation program, which allows deferal of taxes on profits of export subsidiaries, should be repealed, and the taxes defered through DISC should be collected.

Ending these three foreign tax subsidies would raise $6.5 billion in revenues in FY 1984 and over $33 billion in the 1984–1986 period.

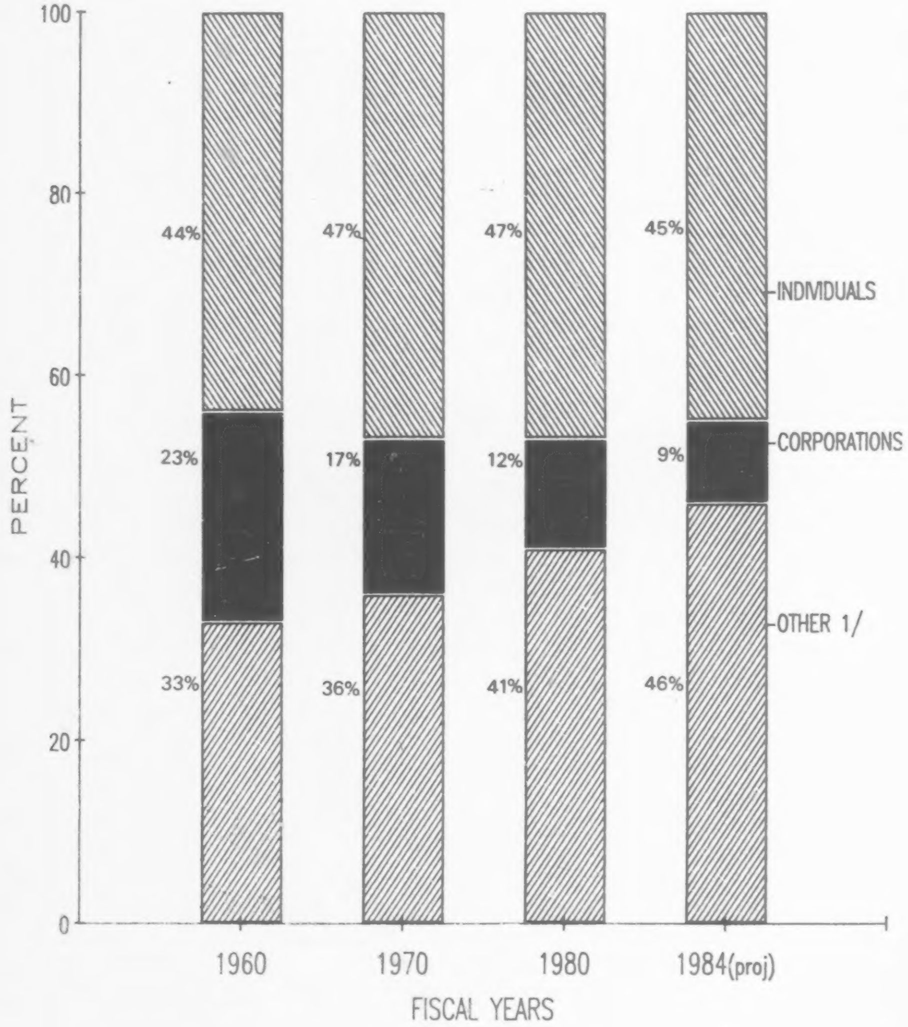
The Investment Tax Credit.—In 1982 Congress went halfway toward eliminating the practice of deducting, as depreciation allowances, costs that were already deducted as investment credits. If the job was completed and business was required to reduce the depreciation base by the full ITC rather than only one-half, over $4 billion would be recaptured in the 3-year 1984–1986 period. Cutting the credit back from 10 percent to its previous 7 percent level would raise over $14 billion in 1984–1986 period.

Oil and Gas.—High on the list of unfinished business is the elimination of the special tax loopholes for the oil and gas industry. Eliminating percentage depletion and the immediate expensing of drilling costs and terminating the 1981 law's Windfall Profit Tax changes would increase revenue in 1984 by $3.7 billion and generate a cumulative revenue increase of over $15 billion during the 1984–1986 period.

We also believe that a temporary surtax should be enacted to meet the current defense budget needs. Such a tax should be levied on both corporations and individuals; the rate should be graduated, and it should include as part of its base the income that currently escapes tax through phantom write-offs, special exclusions and shelters—it could raise annual revenues by as much as $30 billion.

Source of Federal Tax Revenues

Corporations Have Shifted Their Share of the Costs of Government



1/ OTHER INCLUDES PAYERS OF EXCISE AND SOCIAL SECURITY TAXES

SOURCE: HOUSE BUDGET COMMITTEE

Chairman PICKLE. Thank you, Mr. Denison.

Now we will let Mr. Tiner proceed. Mr. Tiner.

STATEMENT OF MICHAEL L. TINER, ASSISTANT DIRECTOR OF GOVERNMENT AFFAIRS, UNITED FOOD & COMMERCIAL WORKERS INTERNATIONAL UNION, AFL-CIO

Mr. TINER. Thank you, Mr. Chairman.

My name is Michael Tiner. I am the Assistant Director of Government Affairs of the United Food & Commercial Workers International Union (AFL-CIO).

For several years, Congress declined to address the question of taxing fringe benefits. Congress statutorily prohibited the Internal Revenue Service from addressing the problem by regulation. At the same time, Congress was providing a statutory income exclusion for certain fringe benefits.

Congress provided an exclusion for these statutory fringe benefits because it believed that the service provided was sufficiently important to warrant encouragement. Encouragement was provided in the form of a statutory income exclusion. The UFCW believes that nothing has changed to merit the withdrawal of the congressional encouragement needed to continue to provide these statutory exempt fringe benefits.

Questions regarding the tax status of non-statutory fringe benefits were resolved recently when Congress passed the Tax Reform Act of 1984. As the committee knows, five categories of fringe benefits were excluded from the employee's gross income for Federal income tax purposes and from the wage and benefit base for purposes of social security.

We also believe that the two sets of fringe benefits, both statutory and non-statutory, minimally should be treated for tax purposes the same way.

As we said earlier, the tax bill of 1984 only partially addressed the question of taxing fringe benefits and did not resolve all of the problems in this area. For example, the statutory exclusion for education assistance was not renewed. As the committee is well aware, this worthwhile program was allowed to lapse because an agreement could not be reached on whether FICA and FUTA taxes would be paid on this benefit. The UFCW opposed efforts to impose FICA and FUTA taxes as the price for excluding educational assistance from withholding tax. Additionally, the tax reform bill did not address the need to extend the income exclusion on group legal services.

Accordingly, the UFCW was pleased to endorse Representative Pete Stark's H.R. 5361 extending for five years Section 120 of the Internal Revenue Code and thus continuing to encourage qualified group legal service plans.

Although legal service plans exhibit considerable diversity in structure, costs and benefits, all plans help remedy the unmet legal service needs. It is important to point out that for the most part these covered employees are receiving preventive legal services that often make it possible to avoid litigation or protracted remedial services.

We sincerely hope that the efforts of Representative Stark will not meet with the same fate as the statutory exclusion on educational assistance.

It is the UFCW's position, Mr. Chairman, that there cannot be any real cost containment until the providers and suppliers of services have strong financial incentives to change. We urge the committee to ask itself whether health care is the right place to look for ways to reduce deficits.

In closing, let me say that we look forward to working with the Chairman in an attempt to come up with a fair and equitable solution to the problem of fringe benefit taxing.

[The prepared statement follows:]

STATEMENT OF MICHAEL L. TINER, ASSISTANT DIRECTOR OF GOVERNMENT AFFAIRS, UNITED FOOD & COMMERCIAL WORKERS INTERNATIONAL UNION (AFL-CIO)

My name is Michael L. Tiner. I am Assistant Director of Government Affairs of the United Food and Commercial Workers International Union (AFL-CIO).

The UFCW is a labor union with 1.3 million members organized in some 600 local unions throughout the United States and Canada. The UFCW and its local unions have collective bargaining agreements with tens of thousands of employers throughout the food processing, retail sales, fur, leather, health, commercial, shoe and other industries.

For several years, Congress declined to address the question of taxing fringe benefits. Congress statutorily prohibited the Internal Revenue Service from addressing the problem by regulation. At the same time, Congress was providing a statutory income exclusion for certain fringe benefits—for example, health and accident plans, life insurance, group legal services and educational assistance to mention a few.

Congress provided an exclusion for these statutory fringe benefits because it believed that the service provided was sufficiently important to warrant encouragement. Encouragement was provided in the form of a statutory income exclusion. The UFCW believes that nothing has changed to merit the withdrawal of the Congressional encouragement needed to continue to provide these statutory exempt fringe benefits.

Questions regarding the tax status of non-statutory fringe benefits were resolved recently when Congress passed the Tax Reform Act of 1984. As the committee knows, five categories of fringe benefits were excluded from the employee's gross income for federal income tax purposes and from the wage and benefit base for purposes of social security and other employment taxes. These five categories are: (1) No-additional-cost services; (2) qualified employee discounts; (3) working condition fringes; (4) "de minimis" fringes; and (5) qualified tuition reductions.

We believe that the usefulness to workers and the nation of statutorily exempt fringe benefits to be far greater than that of the five categories of benefits that Congress just exempted from federal income tax and from wage and benefit base for purposes of social security. We also believe the two sets of fringe benefits, both statutory and non-statutory, minimally should be treated for tax purposes the same way.

We realize that there will be strong pressures to raise revenue to offset the huge deficits created by the tax giveaways of 1981. We suggest Congress look to those who benefited most in 1981 to now begin to share in the burden of cutting the deficit.

In 1979, the AFL-CIO Convention set forth some general principles with respect to taxation of fringe benefits on which Congress should base its actions in the area of fringe benefits.

(1) Sensible "de minimis" rules should be written so that employers and employees need not take into account small benefit values which would cause unreasonable record keeping and administrative burdens.

(2) Benefits that facilitate the employee's work performance, are provided for the convenience of the employer, or other support services, such as the furnishing of uniforms, should not be taxed.

(3) Limited benefits historically and broadly available such as discounts for employees of retail stores should be exempted from taxation.

(4) Provisions of present law, which under specified conditions expressly grant tax exemptions for fringe benefits including, among others, qualified pension plans, group life insurance, health benefits and group legal services should be continued.

As we said earlier, the Tax Reform Bill of 1984 only partially addressed the question of taxing fringe benefits and did not resolve all of the problems in this area. For example, the statutory exclusion for education assistance was not renewed. As the committee is well aware, this worthwhile program was allowed to lapse because an agreement could not be reached on whether FICA and FUTA taxes would be paid on this benefit. The UFCW opposed efforts to impose FICA and FUTA taxes as the price for excluding educational assistance from withholding tax. Additionally, the Tax Reform Bill did not address the need to extend the income exclusion on group legal services.

Since Congress amended the Taft-Hartley Act in 1973 to permit the use of employee benefit trusts to provide legal services, it has acted twice to extend the income exclusion. In 1976, Congress extended Section 120 for five years, and in 1981, it was extended for three years. The UFCW believes that the current tax treatment of qualified group legal services has helped in encouraging the use and protections of these plans at minimal costs.

Accordingly, the UFCW was pleased to endorse Representative Pete Stark's (D-CA) H.R. 5361 extending for five years Section 120 of the Internal Revenue Code and thus continuing to encourage qualified group legal service plans.

Although legal service plans exhibit considerable diversity in structure, costs and benefits, all plans help remedy the unmet legal service needs. Recent studies show that some 35 percent of the population encounters some problems that could be solved by a lawyer, but only 10 percent actually seek legal assistance. By contrast, an average of 20 percent of covered employees in a group plan obtain legal assistance. It is important to point out that for the most part these covered employees are receiving preventive legal services that often make it possible to avoid litigation or protracted remedial services.

Although we were unable to determine the total number of UFCW locals currently providing group legal service benefits to members, we have identified three UFCW locals that provide this benefit. These examples will illustrate the benefit that this program provides:

(1) In the Paterson, New Jersey area, UFCW Local 464A provides free group legal services for approximately 6,500 UFCW members. As the result of recent negotiations, an additional 3,000 members began receiving group legal service benefits August 1, 1984. Local 464A was the first New Jersey local to negotiate group legal services having negotiated this benefit for its members in 1976.

(2) In the Detroit metropolitan area, UFCW Local 876's group legal service plan provides free legal services to approximately 14,000 of its members.

(3) In the metropolitan Washington, D.C. area, UFCW Local 400 has a legal service plan that provides free legal services to approximately 18,000 employees of two area retail chains and their families. An additional 10,000 members and their families, who are not employed by these two chains, qualify for reduced cost legal services by virtue of their membership in Local 400.

By making advance arrangements on a group basis, the time, cost and uncertainty involved in selecting and consulting a lawyer when a legal question arises is dramatically reduced. Thus, though the people covered by a plan tend to contact a lawyer more often, they also do so at an earlier point in the course of a problem. As a result, more people receive legal advice, matters are handled at lower costs and, in a way, that minimizes disputed litigation.

The legal services provided by plans are those most often needed by average citizens, starting with initial legal consultations, advice and routine follow-up, and continuing through routine matters such as wills, divorces, real estate transactions, consumer matters and so on,depending on the level of plan funding. Most plans attempt to provide reasonably generous benefits in case the individual is sued in civil court. Some plans provide some coverage in criminal cases. Traffic and misdemeanor matters are more often covered thatn felonies. Sometimes only the emergency stages (arraignment and bail) of criminal matter are covered. Plans generally tend not to cover matters subject to contingency arrangment, such as personal injury and probate cases. Some plans cover court costs and other litigation expenses. Almost all plans cover both the employee and his family. Coverage for retirees is also frequently provided. Although legal service plans fill a real and important need, their cost is modest.

According to the Joint Committee on Taxation, the annual revenue loss associated with qualified group legal service plans is $25 million. It is likely that if Section 120 were made permanent, the figure would grow as more people are covered. Nevertheless few sections of the tax code have so clearly achieved their objective at such a low cost. We believe that workers should not have to pay taxes on employers' contributions to qualified legal service plans.

We sincerely hope that the efforts of Representative Stark to enact H.R. 5361 will not meet with the same fate as the statutory exclusion on educational assistance.

The UFCW is opposed to the imposition of FICA and FUTA taxes on group legal service benefits. It is our opinion that the attempts to add FICA and FUTA to educational assistance is a harbinger of things to come not only on group legal services but on health and wefare plans as well.

Attempts to cap or limit the amount of tax-free health insurance workers enjoy are not new or innovative. However, prior to current deficit problems, these attemps were billed as a means of controlling rapidly rising hospital costs. Now to help pay for the excesses of the 1981 tax cuts for the wealthy, workers are expected to help balance the budget by allowing Congress to tax their educational assistance program, their group legal service program and their health and welfare program.

Those who advocate taxing health and welfare contributions understand neither collective bargaining or the health care market. If reductions in benefits are required due to the imposition of a health tax, what would be dropped from plans are coverage for preventive care, dental, optical and other benefits which save workers money. What would be left untouched is coverage for hospital and surgical benefits which have been the major source of our health inflation problems and represent a problem over which users have very little control.

We have several other problems with attempts—whether under the guise of cost containment or deficit reduction—to limit tax exempt contributions. They are:

(1) Worker benefits negotiated through collective bargaining should not be subject to the vagaries of the tax code, which force distortion in coverage and encourage circumvention of the process.

(2) Workers in high cost areas will be severely penalized by a national cap.

(3) Employees with chronic conditions and older workers will be forced to purchase expensive supplemental insurance.

(4) The proposal will discourage hiring of older workers and those with higher health care costs.

(5) The proposal discriminates against workers in unhealthy industries, such as coal and steel, where health care costs are higher.

(6) The plan would be almost impossible to administer for the self-insured. Since they do not pay premiums, it would be difficult for tax purposes to determine monthly employer contributions.

(7) The proposal would require opening up large numbers of existing labor contracts, while the issue of whether the proposal will reduce overall health costs is, at best, open to question.

It is the UFCW's position, Mr. Chairman, that there cannot be any real cost containment until the providers and suppliers of services have strong financial incentives to change. We urge the committee to ask itself whether health care is the right place to look for ways to reduce deficits.

In closing, let me say that we look forward to working with the Chairman in an attempt to come up with a fair and equitable solution to the problem of fringe benefit taxing.

STATEMENT OF ALAN REUTHER, ASSISTANT GENERAL COUNSEL, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)

Mr. **Reuther**. Mr. Chairman, my name is Alan Reuther. I am an assistant general counsel for the UAW. The UAW appreciates the opportunity to testify before these subcommittees concerning the tax treatment of employer-provided fringe benefits.

We commend the subcommittees for holding general oversight hearings on this issue. It is especially important for Congress to examine all of the ramifications of the tax treatment accorded various employee benefits—including the availability of these benefits, as well as the tax and fiscal implications—so that it can develop a sound, comprehensive policy before taking any further actions in this area.

The UAW urges Congress to simply extend the favorable tax treatment accorded existing fringe-benefit programs—including educational assistance and group legal services—and to defer consideration of any further changes in the tax treatment of fringe benefits until next year, when it will have had time to consider carefully the information gathered through these hearings and to formulate a comprehensive policy in this area. In particular, Congress should not single out certain benefits—such as educational assistance and group legal services—and try to use the continuation of their favored tax status as a vehicle for instituting major policy changes, such as the imposition of FICA and FUTA taxes on fringe benefits.

There is no need for such drastic action at this time. Taxing these benefits will only bring in a minimal amount of revenue during the next several years.

In addition, careful consideration has not yet been given to the serious (and we believe insurmountable) problems that would be involved in any attempt to impute taxable value to these benefits in a fair and consistent fashion.

The UAW strenuously opposes the various proposals which have been advanced to eliminate or restrict the favorable tax treatment of certain employee benefits. There are two basic reasons for our position.

First, the imposition of Federal income or FICA-FUTA taxes on fringe benefits would constitute a tax increase that would fall most heavily on middle and lower income workers. Taxing fringe benefits cannot be camouflaged by euphemistic desriptions such as revenue enhancement or broadnening the revenue base. This amounts to a tax increase, pure and simple.

The increased taxes would be substantial for middle and lower income workers. For example, if health care and educational assistance benefits were subjected to FICA taxes, the extra yearly tax burden for a typical auto worker would be about $343. The tax burden would be much larger if these benefits were subjected to Federal income tax.

Taxing fringe benefits cannot be defended on grounds of tax equity. The fact is that taxing fringe benefits would make our tax system even more regressive than it already is, because the distribution of fringe benefits—such as health insurance—varies only moderately by income. Furthermore, because there is a cap on the wage base which is used for computing FICA, the imposition of this tax on fringe benefits would be particularly regressive.

Second, the imposition of Federal income or FICA-FUTA taxes on fringe benefits would have a detrimental impact on the distribution and availability of these benefits among the work force. Especially in the case of non-cash fringe benefits—such as health insurance, educational assistance, and group legal services—where the fringes are provided in the form of in-kind services and cannot be converted to cash under any circumstances, the imposition of Federal income or payroll taxes would inevitably have a chilling effect on the commitment of employers and employees to the growth and development of these benefits.

In our judgment, employees are likely to find the taxation of these benefits to be unacceptable, because there would be an increase in their tax burden while nothing is added to their earnings—thus resulted in a net reduction in their take-home pay.

I would like to emphasize that the UAW's position does not represent a blanket endorsement of tax-favored treatment for all fringe benefits—regardless of their nature or the amount of the benefits. We believe that the tax treatment of employee benefits should be based on an evaluation of the merits of the particular benefit involved. The UAW draws a sharp distinction between those employee benefits which protect wage-earners from the vicissitudes of illness, old age, or layoffs through mechanisms they could not set up by themselves, and those benefits which are primarily used as a device to shelter earnings for small groups of upper income individuals.

Using this yardstick we have strongly urged Congress to retain the tax-free status of health insurance benefits, group legal service benefits, and educational assistance benefits. There is no evidence that any of these benefits has been used in a discriminatory manner or as a device by upper income individuals to avoid tax liability.

On the other hand, the UAW did not oppose the employee benefit changes in TEFRA, or the taxation of group life insurance benefits above $50,000. We have also advocated repeal or reduction of the tax expenditures associated with 401(k) plans, IRAs and other tax avoidance devices. And where it is demonstrated that a particular fringe benefit is being abused by professional corporations or upper income individuals as a tax avoidance device, the UAW supports narrowly drawn measures—including limits on the funding or amounts of tax benefits—which are targeted at eliminating those abuses.

However, the UAW is strongly opposed to the enactment of any overall cap on the amount of tax-favored fringe benefits which are available to a worker—regardless of whether this is structured in terms of a flat dollar amount or as a percentage of compensation. An overall cap on fringe benefits would not take into account the different merits of various fringes. It would also introduce inequities among different groups of workers, as well as workers residing in different parts of the country.

The taxation of employee benefits has been proposed by some persons because of concerns about the huge deficits which are currently projected for the Federal Government, and because of concerns about the future solvency of the social security and medicare programs. The UAW share these concerns. However, the Federal budget deficits have been caused by the enormous and unnecessary increases in defense expenditures under the Reagan Administration, coupled with the huge and wasteful tax cuts that were enacted in the Economic Recovery Tax Act of 1981 [ERTA]. Those deficits should therefore be attacked by scaling down the projected course of military spending and by repealing or reducing some of the costly tax provisions that were enacted in 1981 and more recently in 1984.

Thanks to the legislation enacted by Congress in 1983, the social security system is now projected to be financially sound for 75 years. There is no need to impose Federal income or FICA taxs or fringe benefits, in order to "save" social security. It is true that substantial deficits are projected to develop in the medicare program, beginning some time after 1990. However, those deficts are largely attributable to the excessive inflation which has characterized the health care industry in recent years.

Instead of imposing Federal income or FICA taxes on health insurance and other fringe benefits, the UAW submits that the medicare financing problems should be attacked through the institution of comprehensive cost controls on the delivery of health care, such as those contained in the Medicare Solvency and Health Care Financing Reform Act of 1984, H.R. 4870, proposed by Representative Gephardt.

In conclusion, the UAW recognizes that Congress faces difficult choices in dealing with the huge Federal deficits and the financing problems of the Medicare program. Some sacrifices are going to have to be made by everyone if these problems are going to be resolved. However, we do not believe that taxing fringe benefits is the proper solution. Saddling the middle class with taxes on employee benefits to raise additional revenues will simply compound the inequities created by ERTA and make the tax code even less progressive than it already is.

We believe this would be perceived as fundamentally unfair by the public and thus only serve to fuel the "tax revolt" mentality by undermining support for the tax system and useful social programs. Moreover, we believe it would be particularly unfair to single out particular fringe benefits—such as educational assistance and group legal services—for taxation at this time. If the Federal budget deficits and medicare's financing problems are going to be solved in a fair and effective manner, this will only be accomplished through comprehensive tax reform and medicare legislation—not through piecemeal changes in the tax status of certain fringe benefits.

Thank you.

[The prepared statement follows:]

STATEMENT OF ALAN REUTHER, ASSISTANT GENERAL COUNSEL, INTERNATIONAL UNION, UNITED AUTOMOBILE AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)

Chairmen, my name is Alan Reuther. I am an Assistant General Counsel for the UAW. The UAW appreciates the opportunity to testify before these Subcommittees concerning the tax treatment of employer provided fringe benefits.

The UAW represents more than 1.5 million active and retired workers and their families. The collective bargaining agreements negotiated by the UAW provide our members with a variety of employee benefits, including pensions, income protection during layoffs, health care, life insurance, legal assistance, and education and training.

The UAW commends the Subcommittees for holding general oversight hearings on fringe benefits. It is especially important for Congress to examine all of the ramifications of the tax treatment accorded various employee benefits—including the availability of these benefits, as well as the tax and fiscal implications—so that it can develop a sound, comprehensive policy before taking any further actions in this area.

Due to the absence of any comprehensive policy, Congress has recently been sending mixed signals with respect to fringe benefits. The Deficit Reduction Act of 1984 helped to stabilize and rationalize the tax treatment of employee benefits, by codifying the rules governing the treatment of so-called "non-statutory" fringes. At the same time, however, Congress took certain actions in connection with this legislation which could have a deleterious impact on the development of voluntary employee beneficiary associations (VEBAs), supplemental unemployment benefit (SUB) plans, and educational assistance programs.

The UAW submits that Congress should defer consideration of any further changes in the tax treatment of fringe benefits until next year, when it will have had time to consider carefully the information gathered through these hearings and to formulate a comprehensive policy in this area. In particular, Congress should not single out certain benefits—such as educational assistance and group legal services—and try to use the contribution of their favored tax status as a vehicle for institution major policy changes, such as the imposition of FICA and FUTA taxes on fringe benefits.

There is no need for such drastic action at this time. Taxing these benefits will only bring in a minimal of revenue during the next several years.

In addition, careful consideration has not yet been given to the serious (and we believe insurmountable) problems that would be involved in any attempt to impute taxable value to these benefits in a fair and consistent fashion. For example, it is unclear whether taxes would be imposed on the value of services actually received by an employee, or on the value of the contributions, premiums, or payments made by the employer to or on behalf of the employee. There would be obvious problems in valuing any services provided to employees. There would also be problems in determining to whom employer contributions, premiums, or payments should be attributed—especially in cases where an employer makes contributions based on a certain number of cents per hour worked by active employees, but the benefits are actually received by retirees and unemployed persons, as well as active workers.

Accordingly, the UAW urges Congress not to embark on any major policy changes at the present time. Instead, it should extend the favorable tax treatment of existing fringe benefit programs, including educational assistance and group legal services, so that Congress will have time to develop a comprehensive, equitable policy dealing with the tax treatment of all fringe benefits.

The UAW strenuously opposes the various proposals which have been advanced to eliminate or restrict the favorable tax treatment of certain employee benefits. There are two basic reasons for our position.

First, the imposition of federal income or FICA-FUTA taxes on fringe benefits would constitute a tax increase that would fall most heavily on middle and lower income workers. Taxing fringe benefits cannot be camouflaged by euphemistic descriptions such as "revenue enhancement" or "broadening the revenue base". This amounts to a tax increase, pure and simple.

The increased taxes would be substantial for middle and lower income workers. For example, the complete taxation of health care and educational assistance benefits would increase the total yearly tax burden of an average auto worker with a family by about $1300 and $330 respectively. Even if these fringes were only subjected to FICA-FUTA taxes, and not federal income tax, the extra yearly tax burden would still be substantial, costing a typical auto worker approximately $273 and $70 respectively.

Taxing fringe benefits cannot be defended on grounds of tax equity. The fact is that taxing fringe benefits would make our tax system even more regressive than it already is, because the distribution of fringe benefits (such as health insurance) varies only moderately by income. Furthermore, because there is a cap on the wage base which is used for computing FICA, the imposition of this tax on fringe benefits would be particularly regressive. In practical terms, middle and lower income workers who are below the FICA wage base would wind up having tp pay increased taxes, while upper income persons who are already above the wage base would not have any additional tax liability. We believe this would be fundamentally unfair.

Some persons have argued that workers would still benefit by having FICA taxes levied on fringe benefits, because this would enlarge the wage base used to compute their future social security benefit entitlements. We simply do not believe however, that any marginal increase in future benefit entitlements can justify the imposition of the substantial additional taxes that workers would have to pay if FICA taxes were levied on fringe benefits—especially in view of the regressive nature of this payroll tax.

Second, the impositon of federal income or FICA-FUTA taxes on fringe benefits would have a detrimental impact on the distribution and availability of these benefits among the workforce. Especially in the case of non-cash fringe benefits—such as health insurance, educational assistance, and group legal services—where the fringes are provided in the form of in-kind services and cannot be converted to cash under any circumstances, the imposition of federal income or payroll taxes would inevitably have a chilling effect on the commitment of employers and employees to the growth and development of these benefits. The additional costs and administrative burdens will dampen the enthusiasm of employers. And employees are likely to find the taxation of these benefits to be unacceptable, because there would be an increase in their tax burden while nothing is added to their earnings—thus resulting in a net reduction in their take-home pay. The problems inherent in trying to impute taxable value in a fair and consistent manner would also exacerbate employee dissatisfaction.

The favorable tax treatment accorded employer provided fringe benefits has certainly been a factor in the development and extension of these benefits—especially pensions and health insurance—to a very broad segment of the workforce. This has resulted in improved economic well-being and security for millions of workers, and thereby contributed to the general welfare of society as a whole. Taxing these benefits will only serve to curtail their availability, to the detriment of workers and the entire country.

I would like to emphasize that the UAW's position does *not* represent a blanket endorsement of tax-favored treatment for all fringe benefits—regardless of their nature or the amount of the benefit. Rather, we believe that the tax treatment of employee benefits should be based on an evaluation of the merits of the particular benefit involved, including its actual or expected utility to various income and demographic groups. The UAW draws a sharp distinction between those employee benefits which protect wage-earners from the vicissitudes of illness, old age, or layoffs through mechanisms they could not set up by themselves, and those benefits which are primarily used as a device to shelter earnings for small groups of upper income individuals.

Using this yardstick, we have strongly urged Congress to retain the taxfree status of health insurance benefits, group legal services benefits, and educational assistance benefits, which have recently come under challenge. These fringe benefits have helped to make health care, legal services, and education and training available to a broad segment of the workforce. There is no evidence that any of these benefits has been used in a discriminatory manner or as a device by upper income individuals to avoid tax liability.

On the other hand, the UAW did not oppose the employee benefit changes in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), or the taxation of group life insurance benefits above $50,000. We have also advocated repeal or reduction of the tax expenditures associated with 401(k) plans, IRAs and other tax avoidance devices. We continue to strongly support measures which make favorable tax treatment contingent on non-discrimination and other requirements. And where it is demonstrated that a particular fringe benefit is being abused by professional corporations or upper income individuals as a tax avoidance device, the UAW will continue to support narrowly drawn measures—including limits on the funding or amount of benefits—which are targeted at eliminating those abuses.

However, the UAW is strongly opposed to the enactment of any overall cap on the amount of tax-favored fringe benefits which are available to a worker—regardless of whether this is structured in terms of a flat dollar amount or as a percentage of compensation. An overall cap on fringe benefits would not take into account the different merits of various fringes, and would not distinguish between those benefits which are serving important social purposes and those benefits which are being abused as tax avoidance devices. An overall cap would also introduce inequities among different groups of workers, as well as workers residing in different parts of the country. For example, health insurance protection is generally more expensive for workers in high-risk occupations such as assembly-line workers, mineworkers, and steel and foundry workers. And persons residing in Los Angeles have to pay twice as much for a given health insurance policy as persons in Raleigh, North Carolina. Finally, an overall cap tied to a percentage of compensation would be particularly unfair, since it would wind up allowing a greater tax expenditure for upper income persons.

The taxation of employee benefits has been proposed by some persons because of concern about the huge deficits which are currently projected for the federal government, and because of concerns about the future solvency of the Social Security and Medicare programs. The UAW shares the concerns about the need to reduce the federal deficits, and to insure the solvency of Social Security and Medicare. But taxing employee benefits is not the way to accomplish these goals.

The tax-favored status accorded various employee benefits has not been responsible for the creation of the federal deficits or the financing problems of Social Security and Medicare. Although it is true that employee benefits have represented an increasing percentage of wages and salaries in recent years (reaching 32.5 percent in 1982), it is important for Congress to recognize that most of these benefits are not tax-exempt fringes. Indeed, of the 32.5 percent of wages and salaries going to employee benefits, 13.9% was devoted to taxable fringes (such as vacations, holidays, and sick pay), 9.5% was devoted to legally required employer contributions to social security, unemployment and workers compensation, and only 9.0% went to tax-favored fringe benefits.[1] Moreover, of the 9.0% devoted to tax-favored fringes, 4.0% went to pensions and other benefits which simply involve a tax-deferral rather than a tax-exemption. And 4.4% was attributable to health, life and short-term disability incurance benefits. Thus, it is apparent that other tax-favored fringe benefits—such as educational assistance and group legal services—do not represent a substantial portion of employees' compensation, and thus cannot be blamed for the financial problems facing the federal government. The tax expenditures associated with these fringe benefits are minimal, and certainly do not represent a cause for concern.

The federal budget deficits have been caused by the enormous and unnecessary increases in defense expenditures under the Reagan Administration, coupled with the huge and wasteful tax cuts that were enacted in the Economic Recovery Tax Act of 1981 (ERTA). Those deficits should therefore be attacked by scaling down the projected course of military spending and by repealing or reducing some of the costly tax provisions that were enacted in 1981 and more recently in 1984—especially those which eroded the corporate tax base and are further lining the pockets of rich individuals.

Thanks to the legislation enacted by Congress in 1983, the Social Security system is now projected to be financially sound for seventy-five years. There is no need to impose federal income or FICA taxes on fringe benefits, in order to "save" Social Security. It is true that substantial deficits are projected to develop in the Medicare program, beginning some time after 1990. However, those deficits are largely attributable to the excessive inflation which has characterized the health care industry in recent years. Although some persons have suggested that health care benefits ought to be taxed because they have become "excessive" and helped to foster inflationary pressures in the health care industry, this reasoning is simplistic and erroneous. As we will show later in our testimony, the inflation in the health care industry has multiple causes; workers having "too much" health insurance is not one of them. Instead of imposing federal income or FICA taxes on health insurance and other fringe benefits, the UAW submits that the Medicare financing problems should be attacked through the institution of comprehensive cost controls on the delivery of health care, such as those contained in the "Medicare Solvency and Health Care Financing Reform Act of 1984" (H.R. 4870) proposed by Representative Gephardt.

The UAW recognizes that Congress faces difficult choices in dealing with the huge federal budget deficits and the financing problems of the Medicare program. Some sacrifices are going to have to be made by everyone if these problems are going to be resolved. However, we do not believe that taxing fringe benefits is the proper solution. Saddling the middle class with taxes on employee benefits to raise additional revenues will simply compound the inequities created by ERTA and make the tax code even less progressive than it already is. We believe this would be perceived as fundamentally unfair by the public, and thus only serve to fuel the "tax revolt" mentality by undermining support for the tax system and useful social programs. Moreover, we believe it would be particularly unfair to single out particular fringe benefits—such as educational assistance and group legal services—for taxation at this time. If the federal budget deficits and Medicare's financing problems are going to be solved in a fair and effective manner, this will only be accomplished through comprehensive tax reform and Medicare legislation—not through piecemeal changes in the tax status of certain fringe benefits.

Finally, the UAW's support for granting favorable tax treatment to certain employee benefits does not mean that we have abandoned our longstanding support for meeting social needs with federal programs, in favor of a private sector approach. On the contrary, we still believe comprehensive federal programs are the best means of making retirement income, health care, training and other benefits available on an equitable basis to the largest number of persons. Specifically, we continue to support enactment of a national health insurance plan and an effective federal job training program. Government programs are the best way to insure that displaced workers, minorities, women and the poor share fairly in the progress made by the rest of society.

But in the absence of federal action, the UAW and other unions have understood that employer-provided fringe benefits are the only way to insure that large groups of workers have access to necessary protection. Government backing through tax exemptions and deferrals is therefore justifiable for workers to preserve the protections that they now enjoy.

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[1] Cited in Employee Benefit Research Institute, "Testimony on Employee Benefits and Economic Security," June 26–30, 1984, p. 15.

I would now like to discuss in more detail some specific employee benefits.

HEALTH CARE BENEFITS

The expansion of employer health insurance plans since the end of World War II has been dramatic. The growth of group health insurance coverage among workers and their dependents has promoted wide access to health care, particularly throughout the non-elderly population. In 1979, more than 60% of the civilian population was covered by an employer group health plan; nearly 90% of full-time, year-round workers participated in an employer group health plan that year.[2] Coverage has reached beyond the higher-wage sectors of the workforce; the economies of scale associated with greater inclusion of workers in a group plan have encouraged the extension of health insurance coverage to lower-income workers.

This expansion of health insurance coverage, both in numbers and scope, has provided greater financial security and peace of mind to covered families. While the full array of benefits are not available to everyone and millions of people still lack effective access to the health care system, the expansion of health insurance coverage has benefited society as a whole, by contributing to the remarkable improvement in the health of Americans, to their increased longevity, and to the countless breakthroughs achieved in the care and treatment of illness during the last three decades.

One important factor in this development, although by no means the only one, has been the tax-exempt status of employer-provided group health care benefits. The proposals to have workers pay taxes on the health insurance premiums paid by their employers threaten the integrity of existing health insurance plans and would adversely affect beneficiaries. Specifically, the proposal by the Reagan Administration that tax-free employer contributions be limited to $70 per month for individuals and $175 per month for families would be wrong because:

It would create pressure to reduce negotiated health care benefits, to add copays and deductibles, and to drop various coverages (such as dental and vision care) from employee health benefit plans.

It would penalize groups with more older workers who need to use more health care services. This in turn would discourage employment of older workers.

It would act as an incentive for the younger, healthier workers in a plan to leave the plan, opting instead for reduced, inadequate coverage, and raising the cost of the plan to the remaining workers. The fragmentation of plans would add to the administrative costs of employers.

It would penalize workers in higher risk occupations, such as assembly line workers, steel and foundry workers, and mineworkers.

It would unfairly affect certain geographic regions because of variations in medical care costs in different areas.

It would put pressure on employers and unions to reduce coverage for preventive health services. Such barriers to prevention and early treatment of illness could lead to increased use of high cost hospital inpatient facilities.

Taxation of health care benefits would impose substantial, unfair new taxes on working people. If the Reagan Administration's proposal had been enacted, many workers required to pay income taxes on employer premium payments in excess of the "cap" would have wound up paying federal income taxes in 1984 on more than 40% of the health insurance premiums paid by their employer. The tax cap proposal could have cost a worker with a family as much as $300 to $375 per year in increased taxes, equivalent to a cut of up to $7 in his or her weekly paycheck.

From the point of view of tax equity, the taxation of health care benefits would result in a more unfair after-tax distribution of income since employer costs for health insurance are relatively constant with respect to income levels.

The tax cap and other efforts to tax health care benefits would be ineffective in stemming the rapid rise in health care costs. Inflation in the sector is not due to too little cost sharing among workers. Most workers covered by health insurance are still exposed to substantial out-of-pocket payments for personal health services. UAW members employed by the major auto companies, for example, whose health insurance protection compares favorably with the broadest and most comprehensive coverage among American industrial workers, can expect to foot about 30% of their medical care bills on their own. Their program excludes almost all services (except surgery and emergency care) performed by doctors in their offices and requires significant patient copays for such items as prescription drugs, dental care and vision care services.

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[2] Cited in Employee Benefit Research Institute, "Testimony on the Tax Treatment of Employee Benefits," June 22, 1983.

Inflation in the health care industry also cannot be attributed to the expansion of health insurance coverage. In fact, health insurance coverage practically ceased growing in the 1970's while that period and the early 1980s have seen the greatest increases in health care prices along with increases in consumer out-of-pocket payments. It is hard to believe that if we had less coverage or more cost sharing the problems of the health care system would go away.

A careful look at the problem suggests that health care inflation has multiple causes including cost based reimbursement of hospitals, reasonable charge reimbursement of fee-for-service physicians, provider generated overuse of services, proliferation of for-profit health care providers, the introduction and spread of high-tech equipment, aging of the population, excess hospital capacity and the absence of any rational comprehensive cost control program. Taxing health care benefits does not attack these causes of inflation. Indeed, proponents of reducing insurance and increasing patient cost sharing fail to realize that:

(1) There is no study which indicates that cost sharing has any long term effectiveness in reducing total health care costs. One only has to look to the federal Medicare program to see the ineffectiveness of cost sharing in controlling costs. Medicare has had extensive deductibles and coinsurance since its beginning in 1966, and both have increased over the years. Yet the cost of the program to the federal government has risen from $4.5 billion in 1967 to nearly $60 billion in 1984.

(2) The effect of cost sharing on health status is uncertain. In fact, there is some evidence that patient cost sharing can serve as a barrier to early treatment and actually increase costs because more expensive treatment is required for conditions which have deteriorated due to postponement of care.

(3) After the patient makes the decision to go to the doctor in the first place, virtually all decisions about what services are to be provided are made by doctors and other providers. Deductibles and copayments have been shown to have little effect on treatment decisions made by doctors.

Consumers do not admit themselves to the hospital or arrange for their discharges, nor do they make the decision to stay in the hospital for an inordinate amount of time.

Consumers do not write prescriptions for themselves, not do they order an array of unnecessary tests and services for themselves.

Consumers do not decide to build unnecessary hospital beds; neither do they decide to keep beds on line that should be closed down. It is not consumers who permit the continued existence of hospitals that should be closed.

Consumers do not decide to acquire additional expensive equipment already available within the community.

(4) Cost sharing has been shown to have almost no effect on the prices doctors and hospitals choose to place in their services. Providers decide the price of their services, not some free market.

(5) The greatest increases in health care costs in recent years have been in the hospital sector. Yet patient cost sharing has been shown to have even less impact on use of hospital services than on other kinds of health care.

(6) Patient cost sharing discourages access to care by lower-income persons. Study after study has shown that the burden of cost sharing falls inequitably on the poor, on blue collar workers, on minorities, and on those with large families.

In fact, the principal effect of patient cost sharing is to penalize consumers and to distract focus from the more politically difficult issue of holding our health care system accountable to public and consumer goals.

The cutbacks imposed by the Reagan Administration in federal spending for Medicare and Medicaid have not resulted in real health care cost containment. Rather, they have simply shifted costs to the private sector by raising Medicare deductibles, by requiring employers to provide primary coverage for older employees also covered by Medicare, and by allowing providers of care to pass along the burden of certain governmental "cost containment" efforts to private sector payers. The UAW and other unions have negotiated health insurance benefits for their active and retired members and their dependents which supplement Medicare coverage. When Medicare benefits are reduced there are no "savings"; there is simply a massive transfer of liabilities to individuals, insurers and private sector employers. In the case of private sector employers, the transfer of liabilities results in higher health insurance premiums over which neither the employer nor active and retired employees have any effective control. It is unconscionable that the Reagan Administration, which has been responsible for this massive cost shifting to the private sector, also proposes to tax the increased health insurance premiums that result from that shifted responsibility.

A more constructive and effective approach to the problem of rising health care costs is to begin the reform of the overall health care system. Ultimately such reform will be accomplished only under a comprehensive national health program. In the short-run, we favor an approach by which states would establish, within broad federal guidelines, "all payer" systems of prospective hospital reimbursement, negotiated fee schedules for doctors, and fixed diagnostic and laboratory fees. In addition, alternative forms of delivery, such as health maintenance organizations, should be encouraged. A serious example of such an approach is the proposed "Medicare Solvency and Health Care Financing Reform Act of 1984," which has been introduced by Senator Kennedy (S. 2424) and Representative Gephardt (H.R. 4870).

We urge these Subcommittees to consider such legislation as a positive alternative to proposals to tax the health benefits of workers. It would begin to get at the root of the problem by containing escalating costs in the overall health care system through reduction of the inefficiencies and the excessive profits which characterize much of the health care industry. This would be of great benefit to all payers for health care services, including the federal Medicare and Medicaid programs, as well as to private employer-provided health insurance plans.

RETIREMENT PLANS

Like employer-provided group health insurance, employer-sponsored pension plans have greatly expanded since World War II. By 1983, approximately 43% of all employees participated in an employer-sponsored pension plan.[3] The growth of such pension plans has been due in large part to the efforts of the labor movement, which recognized that Social Security needed to be supplemented in order to insure that workers' retirement years would be free of financial worry. However, the tax deferred status accorded to pension contributions has also helped to encourage the establishment of funded pension plans—thus assuring workers a greater measure of security against the risk of poverty in old age, and creating a "safety net" whose benefits reverberate throughout the entire society.

In recent years the tax code has been modified in order to encourage the expansion of salary reduction or 401(k)-type plans, and so-called Individual Retirement Accounts (IRAs), rather than the traditional employer-sponsored pension plans. These are very disturbing developments.

IRAs and salary reduction plans blatantly favor upper income individuals. In the case of IRAs, this is borne out by the results of a May 1983 survey conducted by the Census Bureau for the Employee Benefits Research Institute and the Health and Human Services Department.[4] Of the 16.7 million IRAs established in 1982, 50% were used by the 15% of all survey respondents earning above $25,000. Proportionately more than twice as many workers earning $50,000 or more contributed to IRAs as did workers earning between $20,000 and $50,000, and more than five times as many workers earning over $50,000 contributed to IRAs as did those earning between $15,000 and $20,000. By contrast, coverage under employer-sponsored pension plans is approximately the same for each of these groups: over $50,000, 74.4%; $20,000 to $50,000, 74.4%; $15,000 to $20,000, 63.7%. Salary reduction or 401(k)-type plans are also inequitable because they favor higher-paid employees: only employees who have discretionary income will participate, and those will typically be more highly-paid employees. In addition, contributions are allowed as tax deductions rather than tax credits, again benefiting those in higher tax brackets.

The dramatic expansion of IRAs and 401(k)-type plans has caused a considerable drain on the Treasury. After IRAs were expanded in 1981, the Office of Management and Budget estimated that tax expenditures for them and similar plans would increase by $2.1 billion from fiscal 1981 to 1983. In fact, the total jumped by $11.3 billion; and OMB now projects that IRAs alone will reduce revenues by $14.2 billion in the next fiscal year.

The UAW is also concerned about the growing trend of government policies which favor an "individual account" approach to employee benefits, such as IRAs or 401(k) plans, at the expense of traditional benefit plans. The UAW firmly believes that defined benefit plans meet workers' retirement needs better than other private-sector vehicles because they provide a predictable retirement income and do not subject participants to investment risks. Since benefits can be increased based upon service already accrued, adjustments can be made to take account of inflation both for active employees and for retirees. Flexible funding arrangements allow these costs to be paid over reasonable periods of time. While they are superior to other pension arrangements, defined benefit plans cannot be set up individually; thus the tax incentive provided for establishing these plans on a group basis clearly enhances social welfare.

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[3] Employee Benefit Research Institute Issue Brief No. 32, July 1984.

[4] Ibid.

The promotions of IRAs, which often "promise" to make younger workers millionaires by retirement age, have downplayed the interest-sensitivity of these projections and the impact that the inflation accompanying these interest rates would have on purchasing power. Unrealistic expectations engendered by such promotions could represent a widespread problem in the future.

EDUCATIONAL ASSISTANCE BENEFITS

The UAW is profoundly disappointed by the failure of Congress to establish the tax-exempt status of educational assistance benefits provided by employers as part of the tax legislation which was recently enacted. We believe the continuation of hundreds of programs to improve the education and skills of American workers is now in jeopardy. These programs not only help those directly involved; the public at large also benefits from higher productivity, a more dynamic economy, and a more equitable society.

The importance of these programs is underscored when we look at the massive dislocation of American workers that has occurred in recent years. Recession, import penetration, and technological change have taken an increasingly severe toll, causing an unprecedented number of workers to permanently lose their jobs. In addition, the skills of scores of thousands of active workers are quickly falling behind the demands posed by the new, redesigned jobs.

Within the UAW, our concern about re-employment opportunities for unemployed members and the uncertain occupational future that many currently employed members face has led us to give training and retraining a high priority in our collective bargaining agenda. Early in 1982 we established important new joint training programs with the Ford Motor Company and the General Motors Corporation.

Under both programs, the goal is to provide training, retraining, and developmental opportunities for active and laid-off UAW-represented workers. For laid-off workers, these programs provide invaluable assistance in seeking re-employment. For active workers, the programs have provided an opportunity to upgrade skills and enhance job security.

The response of our members has been enthusiastic. Close to thirty thousand workers have participated in the various educational, training and related programs.

Taxing these benefits will discourage employees from participating in the programs, to the detriment of workers' chances for employment and career advancement. Efforts already in place, including costly buildings and equipment, will be utilized far below capacity or not at all. As a result, the entire economy will be shortchanged.

Failure to reestablish the tax-exempt status of these benefits means a return to the situation prior to 1978, when the IRS required that employer-reimbursed tuition assistance relate solely to present job responsibilities in order to merit tax-exempt status. This will result in benefits being confined mostly to upper-income individuals in executive and management positions, and will clearly restrict the availability of benefits to rank and file workers.

In addition, taxation of educational assistance provides many American workers with a disincentive to invest in their own human potential, in stark contrast to the incentives that the tax code lavishes on business for investment in plant and equipment.

Taxation of educational assistance cannot be defended on grounds of revenue loss: its current impact on the deficit is very small. Indeed, as a matter of revenue policy, taxation of educational benefits seems woefully shortsighted. It makes much more sense to subsidize education and training now, and tax the resulting higher incomes in the future; in effect, we are not talking about exemption as much as about tax deferral, on higher future earnings.

The UAW commends Representatives Shannon and Frenzel for introducing legislation (H.R. 2568) which would permanently exclude employer-provided education assistance from taxable income. We urge the Members of the Ways and Means Committee to act promptly to approve this important legislation.

GROUP LEGAL SERVICE PLANS

The UAW has long been a supporter of group legal service plans. In our view, they represent the best means of making quality, low cost legal services available to average working men and women. Traditionally, legal services have been available in this country only to the top and bottom segments of society. The wealthy and powerful can afford to hire the best law firms. And the very poor are provided free representation through legal aid offices. Average middle class Americans have been left out in the cold.

This situation began to change because of a number of developments in the late 1960s and 1970s. An important one was the addition of Section 120 to the Internal Revenue Code in 1976, making it clear that employer contributions to and services provided under qualified group legal service plans do not constitute taxable income to employees.

That tax change removed an obstacle, and the UAW and other labor unions increasingly began to take an interest in negotiating group legal service plans as a means of assuring that their members have access to quality, low cost legal representation.

The UAW now has approximately 630,000 active employees and retirees, along with their families, covered under negotiated group legal service plans. The reponse of our membership to the programs has been enthusiastic. They have expressed satisfaction with the quality of the legal services provided by the programs. And our members have indicated that they consider group legal services to be an important and valuable fringe benefit which they are interested in preserving and expanding.

The types of legal problems handled by our group legal service plans are diverse. The consumer-debtor services have proven to be especially important for our membership, which has faced financial pressures as a result of layoffs and the recession. The real estate and probate services have also proven to be valuable. By making these legal services readily accessible to our members, they have often been able to obtain legal advice before serious problems have risen.

The UAW remains committed to the growth and development of group legal service plans which can provide quality, low cost legal services to our members. However, the continued growth and viability of group legal service plans would be obstructed by termination of their tax-exempt status embodied in section 120 of the Internal Revenue Code.

Section 120 is currently scheduled to expire on December 31, 1984. If it is not extended, the acceptability among employers and unions of new group legal service plans will be seriously undermined. Worse, the continued operation of existing plans will be jeopardized.

Keeping the tax-exempt provisions for group legal plans will not cause any serious revenue loss for the federal government. The Joint Committee on Taxation has estimated that the tax expenditure associated with Section 120 amounted to only $20 million in 1982. Even assuming that the number and size of group legal service plans were to grow considerably in the future, because such plans are relatively inexpensive, the tax expenditure still would not be of sufficient magnitude to warrant concern.

In order to encourage the continued development and growth of group legal service plans, Congress should now act to extend Section 120. We commend Chairman Stark for introducing H.R. 5361, which would extend Section 120 for five years. We urge the Members of the Ways and Means Committee to act promptly to approve this important legislation. This will give employers and labor unions the assurance they need in the long term viability of group legal service plans in order to make a major commitment to such programs in collective bargaining. In turn, it will help make legal services available to millions of middle class Americans.

FUNDED WELFARE BENEFIT PLANS

For about two decades, most UAW members have been covered by contract clauses providing for supplemental unemployment benefits when they get laid off. These cash benefits have cushioned the impact of cyclical or seasonal unemployment on our members, as well as the communities where they live. While SUB benefits are taxable income to employees, the total contributions made by the companies to the SUB funds have always been tax deductible.

The Tax Reform Act of 1984 limits the deductibility of employer contributions to voluntary employee beneficiary association (VEBAs), supplemental unemployment benefit (SUB) plans, and prepaid legal service plans. We understand that Congress acted because of concern about various abuses associated with "pre-funding" of top-heavy plans by professional corporations. The UAW strongly supports curbing those abuses. However, since no abuses have been documented in connection with collectively bargained plans, there was no justification for extending the funding limits to these plans. As currently structured, the funding limits could have an adverse impact on our SUB plans, because they are not sensitive enough to accommodate the wide cyclical swings in SUB payouts. Specifically, these limits could prevent employers from being able to make sufficient contributions to the SUB plans so that sufficient reserves are built up to pay benefits during future recessions.

The recent history of the UAW-GM SUB plan demonstrates the need for substantial reserves and the adverse impact of the new restrictions. In July 1979, the UAW-GM SUB plan had assets of $443 million. By September 1980, the auto crisis had caused the balance to shrink to $30 million. Under the new law, the funding limits would now restrict the UAW-GM SUB plan to just $367 million, despite the fact that during the preceding seven years which can be taken into account in calculating the funding limits, there were two years (1980 and 1982) when the plan paid out almost $1 billion. Worse yet, by 1990—when neither 1980 nor 1982 can be counted in calculating the funding limits—the UAW-GM SUB plan could be restricted to a potentially inadequate reserve of $150 million.

During the recent depression in the auto and farm implement industries, the existence of large reserves in our SUB plans not only spared many UAW families from destitution, but also cushioned the shock on numerous communities throughout the country which were hit hard by massive layoffs and plant closings. Thus, the new limitations on the funding of SUB plans could have an adverse impact on the general public, as well as UAW members.

Under the new law, the Treasury Department is required to promulgate regulations by July 1, 1985, establishing special reserve limits for collectively bargained plans. We urge Congress to closely monitor the actions of the Secretary, to insure that collectively bargained plans are in fact accorded sufficient flexibility in their funding arrangements.

CONCLUSION

Chairmen, this statement has focused upon a number of important employee benefits, pointing out that they warrant favorable tax treatment because of their merits, the role they play in the lives of broad groups of people, and the non-cash form in which they are paid. There are other employee benefits which I have not discussed due to space limitation, but which are also supported by the UAW. For example, well designed employer sponsored child care programs can provide desirable mechanisms and economies not otherwise available to most working people. They deserve to be encouraged through the tax laws because they accomplish a function not fulfilled by the current tax credit allowed to individuals for child care expenses.

On the other hand, the UAW supports stringent rules against top heavy fringe benefit plans and limits on the amount of pension or severance payments which are tax exempt. Fringes which merely reduce taxable income for those who are already well off and paying less than their fair share of taxes should not receive favorable tax treatment.

The UAW is concerned about the size of federal deficits and supports efforts to raise taxes to reduce them. The attached UAW tax program sets out in detail sources of revenue that would bring in substantial funds, while increasing the progressivity of the tax code and the share of taxes paid by corporations. In the search for higher revenues, the employee benefits I have discussed should be the last source taped, on the basis of the protection they afford to those covered, their positive impact on society and the fact that no federal action seems to be forthcoming in the near future to take their place.

We have appreciated the opportunity to present our views concerning the tax treatment of employer provided fringe benefits. We urge the Subcommittees to give them careful consideration in any future actions relating to the tax status of various employee benefits.

UAW tax program

[Additional revenues for fiscal year 1985 in billions]

Taxation of individuals:	
Cap the third year of the 1981 tax cut at $700	$6.9
Repeal indexation of tax brackets scheduled to begin in 1985	6.2
Restore the estate and gift tax, which was largely repealed by ERTA	2.1
Change IRAs from a deduction to a credit, to provide the same dollar amount of savings to all "savers" regardless of tax bracket	3.7

Phaseout of capital gains preferences. The exclusion should be cut back to the pre-1979 level of 50 percent, and a phasedown begun to totally eliminate this preference over a 5-year period. Special provisions to protect homeowners should be enacted. Capital gains preferences for investing in gold, collectibles, and other nonproductive assets should be eliminated outright. The provision in the Tax Reform Act of 1984 that reduced the long-term capital gain and holding period from one year to 6 months should be repealed	3.9
Taxation of corporations:	
If the corporate income tax were to bear the same share of the federal tax burden in 1984 as it did as recently as 1980, receipts would almost double. One way to move in that direction is by adoption of a minimum tax for corporations. Other measures toward the same goal include:	
Phase out tax preferences related to foreign operations. Foreign taxes should be treated just like other costs of doing business. Right now, foreign tax credits allowed on a dollar-for-dollar basis against a multinational company's U.S. income encourage U.S. corporations to export jobs and to produce abroad. Multinational corporations should not be allowed to defer U.S. income tax payments on the earnings of their foreign subsidiaries until such profits are brought home. The recently enacted Foreign Sales Corporation provision that allows deferral of taxes on export profits is no improvement over the DISC it replaced and like DISC amounts to a wasteful and costly tax expenditure	9.5
Eliminate tax breaks for the oil industry. Oil depletion allowances and write-offs for intangible dwelling costs have no economic justification. They favor both major oil companies and so-called independent producers, and provide a generous tax shelter to the income of highly-paid individuals	6.0
Allow the Research and Development Credit for Incremental Research and Experimentation Expenditures to expire at the end of 1985. The preferable approach is for the federal government to target assistance through a NASA-type agency, so that there is assurance that the new technologies which are fostered will lead to job-creating investment in the U.S.	(1)
Attach meaningful strings to investment incentives. The UAW has long advocated the repeal of across-the-board investment incentives. Most often, they become a windfall for companies that would make the investment anyway. Instead, we support targetted federal relief. Either directly or through the tax system, federal help would be made available to those companies, industries, and regions which need it most and which agree to commit themselves to desirable actions with respect to employment levels, location of facilities, labor standards, etc. While this shift takes place, there should be curbs on the revenue drain related to the investment tax credit and accelerated depreciation schedules. In particular:	
End double-dipping on the investment tax credit. Since 1981, accelerated depreciation write-offs have been allowed on the entire purchase price of new equipment, although as much as 10 percent of the price is offset by the investment tax credit. In 1982, Congress disallowed accelerated depreciation deductions for half the value of the investment tax credit. That job should be finished by allowing depreciation deductions only after the full amount of the investment tax credit has been subtracted	1.3
Stop tax inducements for mergers and acquisitions. Companies should not be allowed to take advantage of the unused tax breaks of firms they acquire. Deductions of interest paid to finance unjustified corporate mergers and acquisitions should also be disallowed	(2)

[1] None in fiscal 1985, but substantial savings in future years.

[2] Not available.

Chairman **Pickle**. Thank you, Mr. Reuther.

I thank all you gentlemen for your testimony. Obviously you have spent a good bit of time on this and feel very strongly about it. Do any of you gentlemen feel that some Members of the Congress, of this committee in particular, are advocating taking away fringe benefits or employee benefits from the employees?

Mr. **Denison**. I don't think they are thinking in those terms, but that would be the practical effect of such an act.

Chairman **Pickle**. What act?

Mr. **Denison**. The effect would be that if there is an imposition of taxes on these benefits, the logical end result, would be a reduction in the benefits.

Chairman **Pickle**. Your contention is that you don't know if anybody is trying to take away employee benefits, but a tax would be the same thing as taking away their benefits?

Mr. **Denison**. That would be the result because eventually the benefits would be eroded.

Chairman **Pickle**. You must have in mind if there is imposition of a FICA or FUTA in any category that would be a tax increase?

Mr. **Denison**. It would be and it is our feeling that if the committee is looking for revenues——

Chairman **Pickle**. There is no bearing if there has to be a tax, FICA, that it would go into social security or unemployment? Would that not help the workers?

Mr. **Denison**. Not to impose further taxes.

Chairman **Pickle**. If the funds went into the social security trust fund.

Mr. **Denison**. These programs came about as a result of a need and they answer a strong social need and they are working well, with no abuse. If we are looking for revenues, we suggest other places to look.

Chairman **Pickle**. There are a lot of ways to look. We know that this committee over the years, each session seems to look at a different way to try to raise revenues. There are a lot of ways, but whether that happens that may take some time, meanwhile we have a question, do we renew the educational exemption? You say yes, we should. I don't know that anybody is going to disagree with you, but you say you must not have any kind of a withholding for social security benefits on it. I guess that is the whole issue. The purpose of these hearings is not just to raise revenue for social security or for the unemployment program, but rather to get on the record here as comprehensive a set of facts to use as a data base as we can to determine the thing to do. That is the purpose of it.

By listening to your testimony, I have a feeling that you have mounted a campaign against FICA and FUTA. We tried to say at the beginning we hope there is not a campaign put on to scare people by the employers or the employees. We have a serious problem in the Congress to determine how to handle these things. If we get involved in a lot of rhetoric or accusations, we might have difficulty establishing a proper level of it. That is my contention. The fact that we have never had anything like that doesn't mean that we should not look at it.

If we have collective bargaining and continue these programs, the question is will they continue to grow and should they grow?

Mr. **Reuther**. If the concern of the committee is that certain fringe benefits are growing such that they are being abused, we believe that the proper response is to place a limit on those benefits.

Chairman PICKLE. I won't argue with you about abuse.

Mr. REUTHER. This was done with pension benefits which we supported.

Chairman PICKLE. We have made corrections on abuses in pensions, we think considerable corrections.

Mr. REUTHER. Take the example of educational assistance. If the committee believes that there are some people getting three or four thousand dollars worth of benefits and that is excessive, we believe the solution would be to place a cap on it, but under our collective bargaining agreements, people are not getting two, three, or four thousand dollars worth of benefits. The maximum amount is $1,000 and we don't believe that that is abusive.

Under the prepaid legal plans, the yearly cost involved for a member is about $48. We hardly think that is an abusive amount.

Chairman PICKLE. Mr. Reuther, you had said earlier with respect to FICA or FUTA that there is no need for such drastic action. Do you call putting a FICA on an educational program a drastic action?

Mr. REUTHER. Yes, I would, because, first of all, the taxes that would be imposed on our members would be significant.

Chairman PICKLE. We will have to look at the facts and have some comparisons to see what is being asked of the employee. That will remain for answer at a later time.

It is difficult for me to see how drastic it is. You point out that the amount of revenue is not important and we ought not to do it. Was that not your statement?

Mr. REUTHER. There is no need for the action to be done this year.

Chairman PICKLE. Because it wouldn't raise that much revenue. If it is not, it wouldn't hurt the employees that much. Getting the benefits but not including it in the wage base works both ways. It seems to me like you are asking for it both ways.

Mr. DENISON. We are finding that every time there is a tax examination up here, it always seems to end up that the workers end up paying the most and we are concerned——

Chairman PICKLE. I hope we haven't done that.

Mr. DENISON. We feel we are being nickeled and dimed to death. Every time there is a tax bill there is more in terms of social security taxes, individual taxes or whatever. When you look at the payments of the Federal revenues now in terms of corporations, that is the only area where it shrunk; but in terms of excise taxes, they have gone way up and those usually fall heaviest on working people.

Chairman PICKLE. I don't think we are going to settle that today.

Mr. DENISON. No, but I am saying perhaps FICA by itself doesn't appear to be a great amount of money, but for a person making $12,000 to $18,000 a year who is being hit continuously with increased taxes at state and local levels, it is cumulative.

Chairman PICKLE. How much of a hardship is that going to apply in actual dollars of an employee's benefit?

Mr. DENISON. I think we would look with some favor if the same tax were imposed on withholding of interest and dividends and capital gains and we start showing concern for that.

Chairman PICKLE. You are trying to balance one against the other. We can't do that today. That is not the purpose. We are trying to ask ourselves, if these benefits grow, how much will they grow?

Mr. DENISON. Our concern is to retain employee benefits. We are in periods now where union after union are giving up health care benefits.

Chairman PICKLE. I don't know of anybody that is trying to take them away.

Mr. DENISON. The economic realities are every union represented here at the bargaining table is being asked to give up eye glass protection, dental protection——

Chairman PICKLE. I don't want to get into that at this hearing.

Mr. DENISON. That is the reality.

Chairman PICKLE. You are saying that this would be a drastic tax on the individual if we held it for legal services or any of these categories. Suppose the Congress is willing to renew educational assistance. That is an important thing in my judgment. It ought to be renewed. But the question is should we renew it with the FICA and FUTA? Would you give up educational assistance if we put FICA and FUTA on it?

Mr. DENISON. No. We would continue to fight for it without FICA and FUTA.

Chairman PICKLE. We think that is a symbolic point in this whole discussion. Do we do this or do we just continue on the same level, and I don't know what position the committee will take, but I think it is important that we ask ourselves these questions because we find in the Congress that many times these benefits are delivered more efficiently through private enterprise working with the employees on choice of benefits. We like that.

The question is how far do we go with it?

Mr. CANTOR. Mr. Chairman, you seem to make much of the notion of symbolism and what will be meant by this and it raises to me the point that I think we agree that the intent of these is not to do away with these benefits, but nevertheless over the past several years the tax structure has been used in the sense of forgiveness, so we tried to encourage retirement, for instance, by reducing taxes on individual retirement income, tried to encourage capital formation by reducing taxes on corporations. Now you are saying that we should increase taxes on workers but that would not discourage something.

I think there is a kind parallel reasoning here——

Chairman PICKLE. I don't want to put a tax on workers, not single out workers. We don't intend that.

Mr. CANTOR. I am just looking for a little of that same kind of symmetry.

Chairman PICKLE. As one of the co-authors of the IRA program, which we think works well, we have almost reached a point where they may become too good, the Congress will have to look at that, how much do we allow into those kinds of programs. We get into the question of what is good tax policy on IRA's, savings, social security and employee benefits and it comes to where we have to ask ourselves on the part of government what is the proper level of it. I don't like the idea of a cap, but I don't know how we control it without some standard and I guess we are looking for that, but none of us that I know of are trying to take away fringe benefits. That is the hue and cry, we are trying to tax them and take them away. I don't accept that.

Mr. DENISON. I think that is the perception out there already. Around the country at the meetings this is the hottest issue.

Chairman PICKLE. That perception is being fed a little bit.

Mr. DENISON. The Wall Street Journal reports that chief executives of corporations say that taxing of benefits probably would mean that benefits will be cut.

Chairman PICKLE. I know it is being observed in the newspapers over the country. I can see the campaign that is afoot. But we need to determine what is the best approach on these programs. We have to decide that and that is the purpose of the hearings.

I want to say that I anticipate that we will be having other hearings on this quesiton. I hope to have another hearing or two between now and the time that we adjourn and we will take them up again next year. We are not trying to rush into some kind of a decision now. This is a very broad question, probably the most vexing problem facing the American people now and we are doing it not for purposes of correcting the deficit, although that is one aspect of it, the question is what is good tax policy and how far does it go and I am sure that you all agree with me on that.

I hope we can work together on this and we will continue to visit with you and talk with you about it and perhaps have other testimony from you and your organizations. So I thank you and appreciate your bringing your testimony.

The subcommittee will stand adjourned until further notice.

[Whereupon, at 2:30 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

STATEMENT OF ROBERT A.G. MONKS, ADMINISTRATOR, OFFICE OF PENSION AND WELFARE BENEFIT PROGRAMS, U.S. DEPARTMENT OF LABOR

My office and the Department of Labor is pleased to submit for the Subcommittees' consideration an overview of the recent growth and development of perhaps the most important single employee benefit—private pensions.

The period since the enactment of the Employee Retirement Income Security Act of 1974 (ERISA) has been marked by a high degree of growth in the private pension system. This growth is particularly evident in the two-fold increase in pension plan assets, the more than doubling of the number of pension plans and the 50 percent increase in total plan participants. Details on the growth of the individual components of the pension system are presented below. A table summarizing many of these trends is appended by my written statement.

PRIVATE PENSION PLAN COVERAGE

The participation rate for full-time private wage and salary workers has remained at about 50 percent since 1972. However, there have been significant shifts in coverage rates among age groups. Between 1972 and 1979 the percentage of covered workers under age 25 decreased from 31 to 27 percent. In part, this happened because a number of plans adopted participation requirements during this period. Workers aged 50–59, however, experienced an increase in coverage, from 54 percent in 1972 to 64 percent in 1979. This increase in the coverage rate of older workers, combined with ERISA minimum standards on vesting and retirement requirements, has significantly increased the number of employees becoming eligible to receive a pension at retirement.

In 1972 the vesting rate for plan participants in their 50's was 42 percent; in 1979 it was 68 percent. Given the low mobility rate of workers in this age group it can be expected that the vast majority of older covered workers will receive a pension. Thus, while the overall coverage rate for full-time workers is 50 percent, as many as two-thirds of all full-time workers can ultimately expect to participate in and vest in a pension based upon the long term jobs which they will find later in their careers.

Women workers, in particular, have benefited from higher coverage rates and minimum vesting requirements. From 1972 to 1979 the overall participation rate for women increased from 37 to 40 percent and for women aged 50–59 coverage increased from 42 to 53 percent. During the same period the overall percent of covered women employees who were vested increased from 26 to 41 percent and for women in their 50's from 31 to 59 percent.

PENSION RECIPIENTS AND BENEFIT AMOUNTS

The number of private pension recipients increased by two-thirds over the last 10 years, from 4.8 million in 1974 to approximately 8 million in 1983. The amount of pension benefits being received has also increased substantially in recent years, both for new annuitants and for retirees already receiving benefits. In 1973 the average annual benefit received by a newly retired annuitant was $2,429. By 1978 new pension recipients were receiving an average annual benefit of $3,947 and in 1983 new recipients were estimated to be receiving an average annual pension of $6,400. From 1973 to 1983 new annuitants have received an initial average benefit 10 percent higher than annuitants retiring the previous year.

In addition to providing increased benefits to new annuitants, many plans periodically increase the benefit rate for annuitants retired in prior years. Generally the increases are provided on an ad hoc basis, with only a relatively small number of plans providing increases based on cost of living provisions. Plan participants retired prior to 1973 received annual benefit increases averaging 3.6 percent from 1973 to 1979, raising their average benefit amounts from $2,128 in 1972 to $2,638 in 1979. The overall benefit increase of 24 percent from 1973 to 1979, however, did not keep pace with consumer prices, which rose 63 percent during the same 6 year period.

NUMBER OF PRIVATE PENSION PLANS AND PARTICIPANTS

From 1975 to 1983 the number of private pension plans climbed from 340,000 to an estimated 775,000. This rapid growth occurred both among defined contribution plans, which increased by 132 percent, and among defined benefit plans, which increased by 120 percent.

Part of the increase in the number of private plans is attributable to employers establishing initial pension plans for their employees. Most of this type of growth occured among smaller firms with fewer than 100 employees and, particularly, among firms with fewer than 10 employees. Because the growth in initial new plans, although substantial, is concentrated among small firms, it has not resulted in any measurable increase in the overall coverage rate.

In addition to the increase in total plans resulting from firms adopting plans for the first time, a significant portion of total plan growth resulted from firms with existing defined benefit or money purchase plans establishing defined contribution plans to provide supplemental benefits. These supplemental plans are frequently profit sharing, savings or stock bonus plans.

In contrast to the concentration in growth of initial plans among small firms, much of the increase in supplemental plans has occurred among very large firms. This has substantially increased the total number of plan participants by providing dual coverage of many workers without affecting the net coverage rate. While the net number of employees covered by at least one pension plan increased from 27.5 million in 1975 to 35.5 million in 1981, a 29 percent increase, the total number of active participants in all pension plans increased from 37 to 50.5 million, a 36 percent increase. The difference in growth rates is attributable to the increase in dual coverage. In 1981 an estimated one-third of all workers in a basic plan also participated in one or more supplemental plans. This compares with a 29 percent dual coverage rate in 1975.

TYPE OF PLAN

For approximately 82 percent of all covered workers basic coverage is provided by a defined benefit plan. Most of the remaining 18 percent are covered by a money purchase plan. About 60 percent of the supplemental coverage is provided by profit sharing plans, with stock bonus plans covering an additional quarter of the dual plan participants. Generally, basic plans are noncontributory, while supplemental plans often require employees to contribute as a condition for participation. Supplemental plans, however, usually provide more liberal vesting. The vesting rate for participants in defined benefit plans is about 46 percent, compared to 82 percent for defined contribution plans, most of which provide supplemental coverage.

PENSION PLAN ASSETS

From 1975 to 1983 private pension plan assets increased from $294 billion to an estimated $900 billion. This represents an average annual growth rate of 15 percent. The average growth rate in 1983 dollars was 6.5 percent. Plan assets are projected to grow to $2.2 trillion in 1983 dollars by the year 2000.

Of the $900 billion in assets held by private pension plans at the end of 1983 almost three-fourths were held by defined benefit plans. The growth rate in assets among defined benefit and defined contribution plans since 1975 has been similar. There is evidence that defined contribution plan assets may grow at a faster rate in the future. The average age of defined benefit plans is 9 years, with plans covering 100 or more participants in existance for an average of 17 years. Over 90 percent of all defined benefit plans are now fully funded and the proportion of retirees to active participants is increasing, causing benefit payouts to increase at a faster rate than contributions. Contributions, however, still substantially exceed benefit payments and in 1980 were 90 percent more than benefits.

In contrast to the more mature status of many defined benefit plans, the average age of defined contribution plans is 6 years, with plans covering 100 or more participants adopted an average of 13 years ago. In recent year a number of very large firms have established employee stock ownership plans and 401K plans, with the potential for rapid growth of assets through accumulation of contributions and earnings. With 62 percent of all defined contribution plans, covering 78 percent of all defined contribution plan participants, consisting of profit sharing and/or stock bonus plans, future asset growth will be dependent to a large extent upon the profitability of the firms sponsoring the plans and the value of the firms' stocks.

CONTRIBUTIONS

From 1975 to 1980 total contributions increased from $38.6 to $64.7 billion, an average of 11 percent per year. However, contributions have been increasing at a lower rate each year and in 1980 increased by only 5.6 percent. The trend toward lower rates of increase in contributions occurs only among defined benefit plans. Among these plans the rate of increase was only 3.2 percent in 1980. The apparent peaking of contributions among defined benefit plans appears to be caused, at least in part, by the fully funded status of over 90 percent of these plans.

Contributions to defined contribution plans are generally made on the basis of a fixed rate, in the case of money purchase plans; on profits, in the case of profit sharing plans; and as a percentage of employee contributions, among savings plans. Reflecting the rapid growth of defined contribution plans in recent years, total contributions have increased substantially, from $13.0 billion in 1975 to $22.8 billion in 1980. In contrast to defined benefit plan contributions, the growth rate of contributions to defined contribution plans has been fairly constant. About 29 percent of total contributions to defined contribution plans consist of employee contributions, compared to only 2 percent for defined benefit plans.

BENEFITS

Benefit payments from private pension plans increased an average of 12.5 percent per year from 1975 to 1980. Benefit payments totaled $19.0 billion in 1975 and $34.3 billion in 1980. Sixty-two percent of pension benefits are paid from defined benefit plans. For these plans benefit payments increased by 76 percent from 1975 to 1980, compared to a 91 percent increase for defined contribution plan payments.

CONCLUSION

America's private pension system is one of the most remarkable institutions of the post-war period. This totally voluntary system has amassed nearly a trillion dollars in private capital to provide retirement benefits to tens of millions of workers over the next several decades. Private pension benefits are already important to large numbers of retirees, and within two decades these benefits may be nearly as important a contributor to retirement income as Social Security for at least a substantial minority of older Americans.

TABLE 1.—NUMBER OF PRIVATE PENSION PLANS, PENSION PLAN PARTICIPANTS AND PENSION PLAN ASSETS BY TYPE OF PLAN, 1975–83[1]

Year	Total plans			Participants (thousands)			Assets (billions)		
	Total	Defined benefit	Defined contribution	Total	Defined benefit	Defined contribution	Total	Defined benefit	Defined contribution
1975	340,171	107,399	232,772	44,511	33,004	11,507	$293.5	$211.4	$82.1
1976	398,407	120,773	277,634	47,679	34,207	13,472	339.8	244.8	95.0
1977	451,458	131,768	319,690	49,928	34,731	15,197	372.3	268.2	104.1
1978	495,845	139,340	356,505	52,371	36,103	16,268	432.6	314.0	118.6
1979	538,751	157,639	381,112	55,192	36,925	18,268	510.3	368.4	141.9
1980	589,893	179,424	410,469	57,903	37,979	19,924	612.3	444.7	167.6
1981	653,370	198,624	454,746	61,700	39,241	22,459	691.9	499.6	192.3
1982	718,847	218,529	500,318	65,200	40,424	24,776	795.7	574.5	221.2
1983	775,477	235,745	539,732	66,800	40,280	26,520	900.0	649.8	250.2

[1] Excludes Keogh plans for the self-employed.

Note.—Data for years 1975–80 based on Form 5500 annual financial reports and on "Pension Facts" published by the American Council of Life Insurance. Data for years 1981–82 based on projected estimates.

STATEMENT OF BURTON E. BURTON, SENIOR VICE PRESIDENT, AETNA LIFE INSURANCE CO.

We welcome the opportunity provided by the Subcommittees on Social Security and Select Revenue Measures to comment on current tax policies affecting employee benefits and whether these policies should be continued.

Aetna Life Insurance Company is the largest group insurer in the country. We have over 50,000 employer customers who are pension and welfare benefit plan sponsors. These employers range in size from the small business persons to the large multinational corporation. We insure or administer benefits for more than 12 million employees and dependents under plans providing life and health insurance. We have as pension clients 80 percent of the Fortune 500 companies. In addition, we are a major plan sponsor for about 80,000 of our own employees and their dependents nationwide. From this vantage point, we have gained a great appreciation of the critically important social value of employee benefits and have in intense interest in the ongoing discussions of tax policy toward benefit plans.

RATIONALE FOR PRESENT TAX POLICY

Employee benefits, including pensions, life and health insurance, have made enormous contributions to the economic security of American workers and their families across the income spectrum. For most employees, anxiety over large medical expenses, an adequate level of retirement income and loss of income from an unexpected, untimely death has been substantially alleviated. In the case of health insurance, it has been virtually eliminated. This degree of economic security is a fairly recent phenomenon, attributable to the growth in scope and availability of private benefit plans which has complemented expansions in the Social Security retirement income and Medicare programs. The value of this combination of private and public plans in terms of social stability and the public welfare is immeasurable, and, we think, beyond argument.

The Congress, in its wisdom, has long recognized the value of promoting organized, efficient ways for people to provide for their future economic security. The Congress has done so directly, with the Social Security system, and indirectly through the private sector by means of tax policy that encourages retirement planning and life and health insurance in the employment setting. We disagree with those who adovate a reversal of this tax policy now for the purpose of raising additional tax revenue. We believe tax preferences for employee benefit plans are in the public interest, have contributed greatly to the development of existing plans and need to be preserved. Indeed, there is at least one area where they may need to be expanded.

Tax-favored treatment of contributions to employee benefit plans has encouraged development of the most efficient way yet devised to provide pension and insurance benefits to the greatest number of people at the lowest possible cost. The group distribution system for benefits is far less costly than individual marketing, which would be the only alternative. Intense competition in the group insurance and plan administration business, economies of scale and the relatively sophisticated buying power of employers and organized employee groups result in employee group coverage that is as much as fifty percent less costly than coverage available in the individual market. Even more important, underwriting of health and life insurance on a group basis makes benefits available to employees and dependents who, because of their age or health status, might find it difficult or impossible to obtain individually underwritten coverage, particularly at a reasonable cost.

Recognition of these advantages of employee benefit plans over alternative systems of distribution has contributed to dramatic growth in the numbers of people covered by these plans.

Those who favor taxation of employee benefits argue that the employee welfare benefit system is mature; that tax policy has hastened the achievement of this maturity; and that the Congress should now withdraw the tax preferences for employee benefits. On the contrary, the goal of adequate coverage for all workers and their families is still being met. Although health insurance (except for dental care) is almost universally available across income levels, its comprehensiveness still varies widely among employers. The financing of long-term care for the elderly may soon become a social problem of alarming proportions. Very few private benefit plan arrangements address this problem. Furthermore, coverage under private pensions is still less than adequate for lower and lower-middle income employees and for those working for smaller employers.

It's clear considerable progress has been made under the current tax policy favoring employee benefits; more progress can be made if these policies are continued.

CONSEQUENCES OF CHANGING TAX POLICY

The consequences, both political and economic, of eliminating or greatly reducing the encouragement given by tax policy to private social protection systems would be severe. While no one knows precisely how employers would respond, reducing the tax incentives enjoyed by employee benefit plans would definitely shift the preferences of both employers and employees away from benefits and towards cash wages. The tremendous progress made in addressing the basic economic needs of American workers would be summarily halted, and more than likely over time, we would be taking steps backwards. The effect on small employers could be particularly pronounced as another layer of disincentives is added to the formation of employee benefit plans.

Perhaps the most disadvantaged from any change in current tax policy are the low income workers. They are the ones who presently are least likely to be covered. Without tax incentives to encourage the provision of new benefit plans, they will be effectively foreclosed from obtaining affordable health and retirement protection. Those low income people who are currently covered will find themselves paying a substantially higher percentage of their cash compensation for taxes. And if employers drop plans in favor of cash compensation, low income people are much less likely than higher income people to replace those benefits from their own resources. For higher income people, many would continue to have the capacity to save (by means of IRAs, annuities, life insurance, etc.), but they may have to pay more for the same benefits if coverages are not available through employers. Furthermore, the effect of the Social Security payroll tax, combined with other taxes, would mean that all employees would face significantly higher taxes.

Some have suggested that the Social Security system is being jeopardized by the growth of employee benefit plans. In reality, the national wage-base subject to the Social Security tax has grown substantially in real terms over the last two decades, during the period of greatest expansion in the employee benefit system. Prospects are for this situation to continue, especially as the growth in now maturing employee benefit plans levels off.

In addition, the specter of additional Social Security taxes poses a serious policy question for the Congress with respect to the current generation of working Americans. Because of the high levels of Social Security (including Medicare) benefits, relative to past payroll taxes paid, that are enjoyed by those currently retired or approaching retirement, it is likely that the majority of those now working will get back less in Social Security benefits than the time-adjusted value of their and their employers' payroll taxes. This situation is acceptable only if the current generation of workers can supplement Social Security benefits with reasonable private sector benefits (particularly pensions). If, however, working Americans find that their private sector benefits have become less adequate at the same time as they are being asked to accept a lower return on their Social Security contributions, the social contract needed to sustain the Social Security system is likely to unravel.

Those who argue that the tax preferences for employee benefit plans should be reduced or eliminated contend that high income people are uniquely advantaged by these plans and would be the only ones to be seriously disadvantaged by taxation of these plans. Yet there is ample evidence that rank and file workers regard employee benefits at least as highly as owners, executives and professionals. In a recent survey by Cambridge Reports, Inc. on employee satisfaction with wages and benefits, lower income households reported being considerably more satisfied with their employee benefits than with their wages. Among higher income households there was virtually no difference.

	Percent very or somewhat satisfied	
	Wages	Benefits
Total household income:		
0 to $8,000	54	65
$8,000 to $12,000	27	59
$12,000 to $15,000	57	71
$15,000 to $20,000	66	80
$20,000 to $25,000	67	63
$25,000 to $35,000	71	76
$35,000 and over	79	79

Unions, even in companies close to bankruptcy, have been reluctant to give up their benefits. Under the present tax structure, they have been more willing to give up wages instead. If benefits became presently taxable, the opposite result would be more likely. Lower income people especially would find it difficult to pay taxes imposed on benefits. After all, these taxes would have to be paid out of their remaining cash income which would presumably not have increased accordingly.

COST EFFECTIVENESS OF PRESENT TAX POLICY

We cannot, however, have our cake and eat it too. We know what public policy should be. The issue is, can we afford to support it? The answer to this question involves two other issues: How cost-effective is the tax preference in buying social protection through the private sector? And where do we rank tax-favored employee benefits in the hierarchy of all the tax preferences in the Internal Revenue Code?

First, it is clear that tax incentives are a particularly cost effective way for the federal government to accomplish the goal of widespread employee protection. Tax incentives act as a lever, encouraging employers and employees voluntarily to skew the compensation package so that it incorporates socially valuable savings and insurance benefits which would otherwise have to be provided by the government. In other words, the government gets a dollar's worth of benefit by spending only 30 to 40 cents.

Second, there is a problem with the way in which the cost or "tax expenditure" for private pensions is estimated by Treasury. While the tax preference accorded health insurance plans is an exemption, taxes on pension contributions are merely deferred. Eventually taxes will be paid when the participants collect their retirement benefits. Obviously, the true estimate of foregone tax revenue is composed of the cost to the Treasury of postponing the receipt of the revenue in time plus (minus) the impact of the retirees being in lower (higher) tax brackets than they were as workers.

Instead, however, of performing this longitudinal estimate, Treasury uses a cross-sectional estimate of tax expenditure, subtracting taxes on this generation of retirees from the foregone taxes on the pension contributions for this generation of workers. Because of the rapid growth in both participation and benefit levels in U.S. pension plans, this is an extremely biased estimate of the true long-run cost to the Treasury of encouraging private pensions. In the long run, the true "cost" to the Treasury may be less than half of what it is projected to be.

Third, the context of these hearings is the need to broaden the tax base in order to raise revenue. The decision on whether or not to tax employee benefit arrangements can be made only after the cost-effectiveness and equity issues that prompted this hearing are asked of other tax preferences too. For example, the tax benefits accorded to home ownership are received by fewer than one-third of all tax-payers (since only one-third itemize deductions) and among these the distribution is heavily skewed toward high income individuals. It would be extremely difficult to make a convincing case that the tax preferences which promote widespread health and pension coverage and are enjoyed by the vast majority of workers, provide a less valuable and less universal social benefit than those supporting home ownership.

In the end, if the objective is to broaden the tax base, the question is which of the panoply of tax preferences should be modified. Only after the whole range of tax preferences has been examined should employee benefits be considered for this purpose.

CONCLUSION

The value to society of present tax policy toward health benefits, pension plans and life insurance is clearly established and has long been recognized by the Congress and the public. Tax preferences for these benefit plans are cost-effective and have promoted a highly efficient means of assuring financial security for workers and their families through the private sector.

Changing this tax policy now would be premature. The full value of employee benefit plans, particularly private pensions, has not yet been realized by lower and lower-middle income employees. More must be done. Those most in need of an organized, employer-sponsored delivery system would be most adversely affected if tax policy ceased to encourage growth in these plans.

In fact, we believe tax preferences should be expanded in at least one direction. There is a growing awareness that the need for financing long-term care for the elderly will soon become a social problem of alarming proportions. Currently, there are very few private benefit plan arrangements that address this issue. We would urge the Congress to consider ways in which federal tax policy could encourage employers and employees to conduct more adequate financial planning for long-term care for the next generation's elderly population.

The Congress should be applauded for its enlightened policy toward employee benefit plans. We sincerely urge the Congress not to jeopardize the future success of these plans.

Statement of the Air Line Pilots Association, International

The Air Line Pilots Association, International represents more than 34,000 pilots under separate collective bargaining agreements with 45 airline carriers. The Association appreciates this opportunity to present our views on the taxation of employee benefits before these Subcommittees.

The Association considers the Federal tax treatment of employee benefits to be a key factor in collective bargaining with employers. As a result, the Association has been successful in securing for effectively all of its members reasonable levels of retirement, life, disability and health benefits through qualified pensions plans, insurance and voluntary employee beneficiary associations (VEBAs). Thus, the tax-exempt status of the qualified pension trust, the exclusion from current income of employer contributions to the trust and the favorable tax treatment accorded distributions from such trust all work together in determining the value of the retirement benefits negotiated on behalf of our members. Similarly, the exclusion from current income of health premiums or benefits and premiums for the first $50,000 of life insurance add to the value of those benefits. The tax-exempt status of negotiated VEBAs has helped to assure our members that adequate funding levels will be maintained with respect to negotiated benefits provided thereunder. Any alterations which lessen the favorable status of the tax treatment of these benefits and trusts will seriously impact the value of the benefits which have already been negotiated, reduce the funding levels of the trusts and undermine the value of our members' existing collective bargaining agreements.

A clear example of the reduction in the value of our existing contracts occurred with the passage of TEFRA. Because pilots' working careers are often shorter than most other employees', due to both the strict medical standards which pilots must satisfy and the Federally-mandated retirement age of 60, retirements benefits are of special significance. TEFRA drastically cut back the maximum levels of retirement benefits and contributions which can be accrued under qualified plans, directly affecting the negotiated retirement benefits and retirement planning of many of our members. Contrary to the collective bargaining process itself, these cutbacks constituted Congressionally-mandated bargaining concessions to the employers with whom the Assocation negotiates, in terms of the lower level of funding required by the lower benefit and contribution limitations. In addition, TEFRA altered the status of prior law raising from 55 to 62 the age at which an actuarial reduction is required from the maximum limits for defined benefit plans. This change further reduced the value of the retirement benefits negotiated on behalf of our members, who by Federal law must retire at age 60.

Another clear example of a cutback directly affecting existing benefits is the modification made to the tax treatment of VEBAs and other funded welfare benefit plans by the Tax Reform Act of 1984. This modification will severely limit the ability of employers to fund adequately for benefits over an extended period. As stated previously, pilots are required to satisfy strict Federal medical standards in order to continue flying. As a result, disability benefits are very important to our membership. In many cases, these disability benefits are provided through VEBAs. However, the stringent medical requirements make claims experience in this area even more unpredictable than it is with respect to other occupations not so regulated. In this regard, a VEBA funded under the new statutory guidelines could very quickly become inadequate to pay disability benefits from one year to another.

Similarly, the provision of retiree medical benefits through a VEBA is jeopardized if the VEBA cannot be funded on a level basis over the working life of the employee, with due consideration given to the escalating costs of medical care. The limitations on VEBA funding may result in employers opting simply to fund these and other benefits on a pay-as-you-go basis, with potentially devastating results in the long run.

Thus, the Association's intention in providing disability and medical benefits through a VEBA, to meet our members' unusual needs on a more level funding basis, has now been legislatively thwarted.

The Association feels the recent legislative cutbacks in employee benefits such as those discussed above are too harsh and does not wish to see further erosion in the value of our negotiated benefits in the name of deficit reduction. Specifically, we would like to address the taxation of health insurance premiums and pension plan contributions.

HEALTH INSURANCE PREMIUM CAP

The proposal has been made to place annual limits on the amount excludable from employees' current compensation by reason of employer contributions for employee health care coverage. The two goals expected to be reached by the proposal are to raise revenues and contain health care costs. However, there is no evidence that either of these goals will be reached.

If a cap is placed on tax-free contributions for health care, the most likely result will be a wholesale reduction in the provision of health care coverage in the United States to the levels that may be purchased with the amount of tax-free contributions. Second, contributions previously made to purchase tax-free health benefits will be shifted, in some cases with union encouragement, to purchase other benefits retaining tax-free status. Third, lowering health care coverage will result in the more frequent utilization of the medical expense deduction by individual taxpayers forced to pay expensive medical bills themselves. Obviously, none of these three results of placing a cap on tax-free health care coverage will yield an increase in tax revenues.

Assuming health care coverages are limited to the levels which can be purchased tax-free, the first benefits to be deleted will be those added most recently, namely, preventive care benefits. Such benefits include dental and vision care plans, outpatient services and other benefits, all designed to contain health care costs. However, the deletion of preventive care benefits would only give rise to additional claims for such basic benefits as hospital and surgical benefits, the most expensive health care benefits provided. Of course, additional claims for such expensive benefits will yield higher, not lower, health care costs.

Besides failing to achieve the goals of raising revenues and reducing health care costs, the proposal to limit tax-free health care coverage takes aim at the wrong taxpayer group—the American worker. Because health care costs are equal whether an individual is in a lower or a higher income bracket, the placement of a cap will disproportionately affect the lower income worker. Assuming health care coverage continues to be provided at a cost above the cap, creating a previously untaxed portion of compensation, lower and middle income workers will suffer a disproportionately higher income tax burden. Assuming health care coverage is dropped to a level which may be purchased at or below the cap, lower and middle income workers will suffer a disproportionately higher health care burden. Because the costs of health care are concededly high, this effect will be devastating to the lower and middle income worker.

It is the very nature of health care coverage, as universally needed by all workers, regardless of income level, which prompted Congress to provide for the tax-free status of employer contributions for such coverage in the first place. Previous attempts to shift the burden of paying for such coverage to those least able to afford it have been recognized as regressive and have been defeated by Congress. Health care simply is not an appropriate vehicle for deficit reduction.

PENSION PLANS

Effectively all of the Association's members are covered by some form of qualified retirement plan. These plans are especially important to our members, because they are federally mandated to retire at the relatively low age of 60. Taxing employer contributions to these plans would not significantly increase tax revenues, since distributions from the plans, in the form of retirement income, are already subject to taxation. Furthermore, taxing the pension trusts themselves would subject such trusts to the risk of underfunding, which risks was largely eliminated by ERISA. This, in turn, would place an increased burden on the already overburdened federal retirement plan insurance program, operated by the Pension Benefit Guaranty Corporation.

Taxing either the contributions to, or the earning of, qualified pension trusts would certainly lead to a reduction in the establishment of pension plans and would act as a disincentive for the negotiation of retirement benefit increases. As a result, the historically important national policy to foster the retirement security of American workers would be effectively defeated.

CONCLUSION

In summary, the Association believes that excessive erosion in the value of negotiated benefits has already taken place. Attacking hard-fought gains in the areas of health care and retirement security is not the appropriate solution to the present tax deficit problem.

STATEMENT OF STEPHEN G. KELLISON, EXECUTIVE DIRECTOR, AMERICAN ACADEMY OF ACTUARIES

BACKGROUND

On September 17 and 18, the Subcommittees on Social Security and Select Revenue Measures of the House Committee on Ways and Means held hearings on the taxation of fringe benefits. The comments belows are submitted for the record of these hearings on behalf of the American Academy of Actuaries ("Academy").

INTEREST OF THE ACADEMY

The Academy is a professional association of over 7,600 actuaries involved in all areas of specialization within the actuarial profession. Included within our membership are approximately 85% of the enrolled actuaries certified under the Employee Retirement Income Security Act of 1974 (ERISA), as well as comparable percentages of actuaries proving actuarial services for other employee benefit plans such as life, health, and disability programs.

The Academy finds it difficult to comment on tax legislation in general, since we are not advocates on major public policy decisions which are not actuarial in nature. The Academy views its role in the government relations arena as proving information and actuarial analysis to public policy decision-makers, so that policy decisions can be made with informed judgment.

Nevertheless and in spite of the fact that actuarial considerations are unlikely to ever be the driving force behind major decisions on tax policy, actuarial input can be quite useful in shaping and molding tax policy to deal appropriately with the extremely complex, yet vitally important, employee benefits area. For example, the determination of required contribution levels to plans to provide the benefits, setting appropriate reserve levels to meet future obligations, and financial calculations involving the time value of money are all actuarial in nature.

GENERAL COMMENTS ON EMPLOYEE BENEFITS PLANS

Employee benefit plans provide an array of insurance and retirement benefits which greatly increase the present and future economic security of millions of Americans. Salary dollars cannot replicate an annuity at retirement that cannot be outlived, life insurance for the family of a deceased worker, the cost of hospitalization in the event of major illness, or income to a disabled worker. Employee benefit plans deliver dollars at the time they are needed most. Moreover, in general, these benefits can be more economically provided on a group basis to an employee workforce than on an individual basis, due to the significant savings in administrative costs and to the stability that comes with a pooling of risks across a broad cross section of employees.

There is no question that the growth of employee benefit plans in the past few decades has been greatly stimulated by tax policy toward those plans. This tax policy has been the result of deliberate Congressional intent which has been demonstrably successful in fostering the development of employee benefit plans. It would be naive and erroneous to assume that employers would continue to provide the same level of benefits in the event that the favorable tax treatment of certain types of employee benefit plans were significantly curtailed or even eliminated. The pressure from employees with the basic attitude "If I have to pay taxes on it anyway, give it to me in cash" would simply be too great. The end result would be a decline in the level of protection provided by the private sector, inevitably leading to greater demand and strain on governmental programs. Given the financial difficulties facing programs such as Medicare and Social Security, a decline in private sector programs would hardly seem to be in the public interest.

NEED FOR NATIONAL POLICY

We hope these hearings will be useful in focusing attention on the need for a coherent, stable, and strongly articulated public policy toward employee benefit plans by the federal government. The fact that no such policy exists leads to a seemingly endless series of ad hoc changes and confused signals toward employee benefit plans. In the tax area alone in just two short years we have seen the Tax Equity and Fiscal Responsibility Act of 1982 and the Deficit Reduction Act of 1984. And now before this last bill has even been printed into final form, Congress is talking about changing it all around again in 1985.

There is a crying need here for more stability in the tax treatment of employee benefit plans. Pension and insurance plans in particular involve long-term arrangements and commitments. Plan sponsors are finding it increasingly difficult to make rational decisions in such a chaotic environment. Much as this continual turmoil may provide additional work for actuaries, it hardly seems to be in the public intest to make the rules so complex and to change them so often that the typical plan sponsor has no chance of coping. The administrative costs of complying with all the changes being imposed on plans has risen significantly and is increasingly becoming a burden, particularly on small plans.

TAX EXEMPTION VS. TAX DEFERRAL

In some of the debates on tax policy the distinction between tax exemption and tax deferral seems to get lost. Although some employee benefit plans do provide tax exempt benefits, others do not. In particular, the major retirement income programs provide for tax deferral, not tax exemption. Within debates on tax deferral we increasingly hear arguments involving the concept of the "time value of money." This is a concept at the heart of actuarial science.

It is quite true that a dollar to be paid in the future is worth less than a dollar today because of the interest that can be earned in the interim. Translating this into tax policy for the federal government, the argument is heard that $1,000 of taxes today is worth $1,000, but if these $1,000 of taxes can be deferred for ten years their present value is worth only $386 if discounted at a 10% rate of interest. Thus, the argument is made that it is better for the Treasury to get the money now rather than later.

What this analysis overlooks, however, is that in many cases the Treasury will get more than $1,000 at the end of ten years. For example, consider a defined contribution pension plan in which the account balances are growing at a 10% rate of interest. $1,000 in tax deferral will continue to grow in the account and will amount to $2,594, not $1,000, in ten years. The present value of $2,594 discounted for ten years at a 10% rate of interest is exactly $1,000!

In the real world, of course, things are seldom this simple. Differences in value will arise if the rate of accummulation is different than the rate used in computing the present value. Also, there is a question about how the tax rates in ten years which will then apply compare with the tax rates which would apply today. However, the example does clearly illustrate that introducing the concept of the time value of money does not, on its own merits, make a convincing case against tax deferral. It is a valid analytical tool, but must be carefully applied in any analysis to present meaningful comparisons.

PUBLIC SECTOR PROGRAMS

If Congress intends to take a comprehensive look at the taxation of employee benefit plans in order to create a more coherent tax policy toward such plans, then it would seem appropriate to consider the tax treatment of public sector programs as part of such a comprehensive review. For example, at the present time the tax treatment of retirement benefits attributable to employer contributions under Social Security is different than for private sector retirement plans. This may or may not be good public policy—that is not an actuarial judgment. However, we do urge the Congress to review tax policy toward insurance and pension benefits under government programs as well as private sector programs in any comprehensive review of the taxation of employee benefit plans.

It is also important to consider how private sector and public sector programs fit together. For example, the integration of private pension plans with Social Security has been a controversial tax issue for a number of years. Actuarial considerations are vital in structuring sound integration rules for pensions or other employee benefit plans.

ACTUARIAL ISSUES

There are six actuarial issues related to the general subject of the taxation of employee benefit plans which we address below.

1. Financial condition

The maintenance of a well-run insurance or pension employee benefit plan involves the determination of both an appropriate contribution level to provide the expected benefits and appropriate reserve levels to cover the accrual of benefit obligations. Both of these are actuarial processes.

Tax policy should recognize the need for these determinations to be made according to sound actuarial principles and practices. Such recognition does exist in the pension area under ERISA. However, that recognition is not as clear in connection with certain insurance programs.

The Academy stand ready to work with Congress and regulatory agencies to define such sound actuarial principles and practices where required. A major priority for the Academy at the present time is the establishment of a structure within our profession to articulate actuarial standards of practice. This structure would be appropriate to deal with issues such as actuarial principles and practices in connection with insurance and pension employee benefit plans. Included in actuarial principles and practices are such matters as disclosure requirements and the content of an actuarial report.

2. Qualifications

Along with a recognition of the need for plans to be operated according to sound actuarial principles and practices there is the need to define the qualifications of the actuaries certifying the plans.

Of course, this need was clearly recognized in ERISA and in that instance Congress chose to create a Joint Board for the Enrollment of Actuaries to examine and license individuals as "enrolled actuaries."

Another example has arisen in the Deficit Reduction Act of 1984. This act provides that in connection with funded welfare benefit plans (including voluntary employees' beneficiary associations (VEBAs) under section 501(c)(9) of IRC) reserves in excess of "safe harbor" limits will be permitted if certified by a "qualified actuary" (to be determined under Treasury regulations).

Academy membership includes actuaries in all areas of practice and serves as the hallmark of a qualified actuary in the United States. However, we recognize that not all actuaries are necessarily qualified for all assignments. Accordingly, our Guides to Professional Conduct contain extensive guidance to ensure that: "The member will bear in mind that the actuary acts as an expert when giving actuarial advice and will give such advice only when qualified to do so."

The Academy has a Committee on Qualifications to address issues such as these. We strongly urge direct participation of the actuarial profession in defining the qualifications of an actuary to engage in any particular assignment. The Academy has a strong commitment to self-regulation and is prepared to work closely with the Treasury if such regulations are to be developed.

3. Actuarial assumptions

The setting of actuarial assumptions is a key ingredient in any actuarial assignment. The provisions relating to funded welfare benefit plans in the Deficit Reduction Act of 1984 (cited above) require that assumptions be reasonable in the aggregate. This is quite appropriate and follows the precedent set by ERISA in the pension area.

However, the conference report goes further and indicates that "in addition to requiring that actuarial assumptions are to be reasonable in the aggregate, Treasury regulations may prescribe specific interest rate and mortality assumptions to be used in all actuarial calculations." Such a simplistic approach would ignore the fact that experience is different from plan to plan for a variety of reasons (age/sex composition of group, nature of work, geographical area, etc.). Attempting to mandate any set of uniform assumptions will inevitably result in inappropriate assumptions being used for large numbers of plans. Setting appropriate actuarial assumptions requires the application of actuarial judgment to fit the facts and circumstances at hand.

We are concerned at the prospect that the Treasury might attempt to prescribe specific actuarial assumptions for funded welfare benefit plans. We believe the approach used in ERISA for setting actuarial assumptions for pension valuations is much more appropriate.

4. Current tables

Certain portions of the Internal Revenue Code require the use of actuarial tables promulgated by the Internal Revenue Service. Examples are the tables for the taxation of group term life insurance under Section 79, the tables for the taxation of annuities under Section 72, and the tables used for the taxation of life estates and remainders.

Some of these tables have been allowed to get out-of-date. For example, the uniform premium table for group life insurance under Section 79 was changed in 1983, but the prior table had been in effect since 1966, during which time group term life rates dramatically changed. As another example, the current tables under Section 72 have not been changed since their release in 1954.

The use of actuarial tables to compute certain values required in the IRC is quite appropriate, but may appear arcane or even obscure to many taxpayers. Maximum credibility will be achieved if taxpayers perceive that the tables are based on current interest and mortality factors rather than ones that may appear obsolete. Such credibility should be an objective of tax policy.

5. Design aspects

On occasion, actuarial insights on design aspects of certain tax proposals may be useful. For example, in the Academy testimony to the Senate Committee on Finance on June 22, 1983 on proposals for a health insurance tax cap, our Committee on Health Insurance pointed out some technical flaws with the proposal to base the tax cap on premiums. The Committee went on to suggest basing it on the richness of coverage provided as an alternative which would avoid these flaws.

[NOTE.—The Academy neither supports nor opposes such a tax cap. This is a public policy decision up to Congress and is not an actuarial issue. However, we are concerned with the technical details of any such proposals and their full ramifications.]

6. Adverse selection

A rather subtle, but potentially quite important, actuarial concept is the notion of "adverse selection." There is a natural tendency for any person covered, or potentially covered, by an insurance or pension plan to exercise any options available to his or her apparent advantage, i.e. to select against the plan. Within limits, the cost of such adverse selection can be absorbed by a plan. For example, in pension plans with lump-sum options, retirees in poor health will tend to elect lump sums, while those in good health will tend to elect life annuities. In such a case, the plan sponsor has been willing to assume any extra costs involved in allowing such options.

In some cases, however, adverse selection could present more serious problems. For example, consider a voluntary health insurance program with substantial employee contributions required (either directly through payroll deduction or indirectly through a health insurance tax cap). Younger, healthier employees will tend to opt out of the program if they do not perceive they are receiving adequate value for their contributions. If this happens, the group left behind will increasingly consist of older or less healthy employees, and costs would increase significantly. In extreme cases, this could result in a vicious cycle of further defections of healthy employees as costs rise and spiralling cost increases for remaining participants, until the entire financial structure of the plan is undermined.

Although the collapse of a plan due to adverse selection alone may appear a bit farfetched, it is not impossible. On a lesser scale, adverse selection can and does increase the costs of certain plans.

Congress should be careful in structuring tax policy toward employee benefit plans to be aware of such subtle possibilites and not inadvertently undercut the financial strength of plans to play benefits which have been promised.

SUMMARY

In summary, we encourage Congress to proceed carefully in structuring a rational tax policy for employee benefit plans. To the extent that revenue enhancement is the objective, Congress must weigh this "gain" against the costs if private sector plans are discouraged, and less economic security is thereby provided by the private sector. To the extent that elimination of real or perceived tax abuse is the objective, we strongly encourage Congress to use the scalpel and not the meat ax, since the large majority of benefits under employee benefit plans are not being provided with tax avoidance as the primary motivation.

We appreciate the opportunity to present these comments for the record. The Academy is available to offer an actuarial perspective on the taxation of employee benefit plans in future considerations of such policy. We would be happy to answer any questions or provide further information for the Subcommittee upon request.

Statement of the American Dental Association

The American Dental Association is extremely concerned with proposals to tax employees for employer fringe benefit contributions. The Association is specifically concerned with efforts to tax employer provided health benefits. The Association believes that such tax proposals will not raise significant revenues and could prove to be very injurious to the continued existence of successful, prevention-oriented benefits such as dental prepayment plans. Following is the Association's response to those questions asked by the Subcommittees which are pertinent to dental coverage:

(1) Approximately 90 million Americans (employees and their families) are covered by employer sponsored dental benefits. This represents an expansion from coverage of approximately 6 million Americans in 1968. The Association anticipates that expansion of coverage, although not as rapid as in recent years, will continue as long as the existing tax structure with regard to fringe benefits is maintained.

(2) Almost universally, employers who offer dental benefits provide them equally for all their employees.

(6) With regard to dental benefits, different effects are likely to occur based upon implementation of a fixed dollar tax exempt limit, a flat excise tax or a limit on the percent of compensation which could be accorded on a tax exempt or tax deferred basis. Also different results would occur depending upon whether or not the limits relate to all fringe benefits or just to health benefits.

A fixed dollar limit on tax exempt benefits will result in employee efforts to avoid taxation by assuring that their level of benefits are below the dollar limit. One result of this effort will be to provide little or no revenues to the federal government. As a general rule, it can be anticipated that employees will be willing to forego benefits in approximately the reverse order of gaining them. If only health benefits are subject to the limit, it seems quite clear, and studies have shown, that dental benefits will be one of the first to be dropped if they are subject to taxation. The result would be that a cost effective, prevention-oriented benefit would be lost to employees while no revenue gain would be achieved by the federal government.

If all fringe benefits are subject to the limit, we expect that individuals would prefer to receive taxable cash payments rather than taxable fringe benefits. Accordingly, reductions in fringe benefits will occur. The order of that reduction would depend on the benefit package. Certainly coverage for medical and hospital care, the leading contributors to health cost inflation, will be continued in as comprehensive a manner as possible by employees. We believe that the effect of a flat excise tax or a percentage limit on fringe benefits would result in a reduction of the extent of fringe benefits provided to employees.

(7) To the American Dental Association the relationship between employer sponsored fringe benefits and federal social programs is one of the key issues to be addressed in this entire debate. We believe that employer sponsored fringe benefits have played a significant role in reducing or preventing the need for massive federal programs. Certainly employer sponsored health benefits have been a key reason that this nation does not need a comprehensive, federally run national health insurance program.

Within this framework dental benefits have provided the opportunity for increased millions of Americans to receive dental services. This has resulted in improved oral health for these individuals. As the same time dental fees have increased at a rate which is below the overall Consumer Price Index. Improved oral health at controlled costs provides a very significant social benefit to Americans. We believe it to be clear that the establishment of impediments to the availability of dental benefits will directly result in a lowering of the oral health of this nation.

It is more efficient to encourage employers to provide dental and other fringe benefits with tax incentives as opposed to providing benefits through publicly funded programs. The private employer sponsored system already is in place, economic incentives exist to encourage efficiency and the results have been successful. It would seem to us to be unwise to establish barriers which will perhaps necessitate the need for new, untried and inevitably very costly government run programs.

We thank you for your consideration of our views. Once again we must urge that these Subcommittees not recommend tax policies which will impede the growth of valuable fringe benefits such as dental prepayment plans.

STATEMENT OF THE AMERICAN DENTAL HYGIENISTS' ASSOCIATION

INTRODUCTION

Mr. Pickle and members of the Subcommittee on Select Revenue Measures, the Association is pleased to be able to submit record testimony on the issue of fringe benefit taxation. We hope that this statement will be included with the record of the September 17-18 hearing.

COMMENTS ON FRINGE BENEFITS TAXATION

The American Dental Hygienists' Association is pleased to have this opportunity to submit a record statement to the Subcommittee on Select Revenue Measures of the Ways and Means Committee on the issue of fringe benefits.

The Association represents approximately 30,000 dental hygienists who are specialists in the delivery of preventive dental care. The majority of the members of the Association practice dental hygiene in offices of private practice dentists but an increasing number practice in institutional settings which include nursing homes, long-term care facilities for the aging, special care facilities for the disabled and handicapped, correctional institutions, hospital dental clinics, dental hygiene and dental schools, community health centers, etc. As preventive oral health specialists, the role of dental hygienists is expanding substantially in reducing the incidence of dental caries and preventing the onset of periodontal disease.

The Association submitted a record statement to the Senate Committee on Finance in May 1983, addressing the proposed "tax cap" on employer-paid health insurance. The Association was concerned at that time that estimated income to be derived from a tax on health insurance would be used to finance a health insurance program for the unemployed which the Committee was also considering. The Association expressed deep concern that the linkage between the "tax cap" proposal and health insurance program for the unemployed be carefully studied before any action was taken by the Committee. We are pleased that the Committee did not act on either proposal and that now a record is being developed in the House of Representatives on the issue of fringe benefits generally with a view towards developing tax policy that will be fair for employers and employees.

The Association understands that the Subcommittee wished to develop a full and fair hearing record on current fringe benefit topics but, as providers of preventive dental care, our statement for the September 1984 hearing will focus on dental insurance and the importance of maintaining the oral health of more than one third of the nation's population who have employer-paid dental insurance for employees and their families.

The Health Care Financing Administration has just reported that spending for dental care in 1984 should reach $23.7 billion. Only $1 billion of this amount represents federal, state and local government funds. Patients out-of-pocket expenses totaled $15.8 billion and private dental insurance accounted for $6.9 billion. Expenses for dental care are expected to increase to approximately $31 billion in 1987 and $39 billion in 1990. The proportion of this total generated through employer-paid private dental insurance can be expected to increase, with such increases continuing through this decade. It appears possible that employer-paid dental insurance could account for up to $10 billion of the estimated $39 billion dental expenditures in 1990.

Among the vast array of fringe benefits that will be considered during the September 1984 hearings, the Association will confine its comments to private dental insurance plans and urge that this fringe benefit remain completely tax free for employers and employees. The Association's rationale for urging that the *status quo* be maintained on dental health insurance plans was presented to the full Senate Committee on Finance last year and it is unchanged in 1984.

As an organization which represents preventive oral health specialists, it is logical that the Association encourage the Committee to develop tax laws which encourage employers to provide fringe benefits, especially oral health benefits, for their employees. For the past 40 years health care benefits have been the central part of what is now known as "fringe benefits" which are negotiated between labor unions and industry and among these, beginning in 1954, was included dental pre-payment insurance (the International Longshoremen's and Warehousemen's Union-Pacific Maritime Association and the west coast shipping industry).

The pre-payment of dental services, both preventive and restorative, has been a fact of life for three decades and has led to a life style that regards dental health as ranking in importance with general health and well-being. The 98th Congress recently passed the comprehensive debt reduction bill, leaving the proposal to tax health care benefits for the next Congress to consider and current law, which does not require that health care benefits be taxed, is still in force.

DO EMPLOYEES BENEFIT FAIRLY FROM THE TAX INCENTIVES?

Dental benefit plans, according to the American Dental Association, help to control dental costs. Dental insurance rewards patients who take care of their teeth in order to avoid oral disease which would require expensive restorative care.

Major dental benefit plans, in most instances cover 100 percent of the cost of diagnostic and preventive treatment, which includes routine oral examination, prophylaxis, fluoride treatment, pit and fissure sealant applications, x-rays, tooth charting and periodontic charting. All of these procedures, performed generally by dental hygienists in most dental offices, are preventive oral health measures intended to help patients avoid dental disease, such as dental caries and periodontia.

Most dental benefit plans are negotiated under the collective bargaining system between labor and management. While the plans may vary in dental coverage from industry to industry, they provide benefits fairly among the employees. Co-payment requirements in most dental benefit plans help to control the cost of dental services and encourage employees to care for their teeth. Failure to do so, with the co-payment features of these plans, requires more out-of-pocket expenses by employees.

ARE EXISTING BENEFITS EFFECTIVE IN ENCOURAGING EMPLOYER TO PROVIDE THEM TO EMPLOYEES AT A LOWER COST THAN GOVERNMENT?

Earlier in this statement, we cited a current report of the Health Care Financing Administration on the nation's spending for dental care in 1984. It is significant that spending for dental care by federal, state and local governments was only $1 billion of a total annual expenditures of $23.7 billion. On the other hand, patients themselves spent $15.8 billion and dental benefit plans accounted for nearly $7 billion of the 1984 dental bill.

It appears that existing benefits for dental care do encourage employers to provide dental care at acceptable low cost levels, as opposed to providing benefits by governmental agencies. The provision of dental care under Medicare and Medicaid has been historically and traditionally minimal and inadequate.

CONCLUSION

The American Dental Hygienists' Association is a health provider organization and is unquestionably dedicated to providing preventive oral health services to the people of this nation. If the Association's goals and objectives to eliminate dental disease appear to represent a special interest group to the Subcommittee, we can offer no disclaimers or apologies. Our special interest is the promotion of oral health to all who seek it and need it.

The Association believes that taxing health care benefits, namely dental benefit plans, is an unhealthy idea which will defeat the great progress made by the dental hygiene and dental professions over the past three decades. The incidence of dental caries has declined and periodontal disease has become a focal point of treatment by the dental hygiene and dental professions. If oral health is a national goal and objective—and the Public Health Service Surgeon General thinks it is—we believe that dental benefit plans should remain tax free and that current statutory law should not be changed.

Despite our bias in addressing the issues of fringe benefits, the Association recognizes that the House Ways and Means Committee, and the Congress generally, are confronted with a dilemma. The plethora of fringe benefits is impacting on the nation's revenue base. Congress and the Executive Branch as well, are compelled to act. If revenues must be increased to offset deficits, it is apparent that the tax-free health insurance fringe benefit will be carefully scrutinized.

The Association recognizes the problem of fringe benefits which the Subcommittee is addressing in this hearing and we are sensitive to the need in Congress to develop solutions to increase revenues in order to reduce massive federal deficits. It is our hope, however, that fringe benefits for health care, especially oral health care, will not need to be taxed.

We know that the Committee and Congress will need to make some difficult decisions about whether fringe benefits should be taxed.

If the concept of taxation of employee benefits is accepted, the next step is to decide which ones to tax and which to allow to remain tax free. It is our hope that Congress will opt for healthy Americans and Americans with healthy teeth and gums and save the tax free status of dental benefit plans.

STATEMENT OF THE AMERICAN HOSPITAL ASSOCIATION

SUMMARY

While the tax system should be designed to encourage employers to provide an adequate level of health benefits to their employees, it should not be open-ended. Individuals whose employer contribution exceeds a set limit could instead maintain their current insurance levels with after-tax dollars, thus discouraging the purchase of unneeded insurance.

Excessive health benefits are inflationary and insulate all elements of the health care system from health care decisions, contributing to inefficient use of health care resources.

Reducing the rate of inflation in the health care sector requires addressing not only Medicare and Medicaid outlays but also private health spending. The limit on tax-free benefits would help address these issues without limiting an individual's opportunity for protection against the serious financial consequences of illness.

INTRODUCTION

On behalf of our 6,100 institutional members and 38,000 personal members, the American Hospital Association (AHA) is pleased to have this opportunity to present our views on employer-provided health insurance benefits as part of your general examination of the distribution and economics of employer-provided fringe benefits.

Under current law, an employer's contribution to an employee's health plan is a tax-free fringe benefit—the second largest statutory fringe benefit in the tax code, with the revenue loss estimated to be $18.6 billion in Fiscal Year 1983 and over $20 billion in Fiscal Year 1984.

The AHA strongly supports legislation introduced by Representative Conable (H.R. 2575) which would limit tax-free employer-paid health benefits to $175 per month for a family plan, and $70 per month for an individual employee plan. The limit would be indexed to increase yearly in proportion to the consumer price index. Employer contributions above these amounts would be added to employee income and taxed accordingly.

This proposal would reduce the revenue loss to the U.S. Treasury by $2.1 billion in FY 1984, $4.2 billion in FY 1985, $6.0 billion in FY 1986, $8.0 billion in FY 1987, and $10.7 billion in FY 1988.

More important, according to the Congressional Budget Office (CBO), medical care prices would be about 2 percent lower in 1987 than under current policies if a tax cap were enacted and increased accordingly in future years. For the 85 percent of the population with employer-based health insurance, spending on insured medical services would be an estimated 9 percent lower in 1987. Studies conducted by the

National Center for Health Services Research (NCHSR) and many health economists also agree that such a proposal would help control health care cost inflation.

COST CONSCIOUSNESS

The current tax treatment of health insurance premiums has substantially increased the demand for comprehensive insurance that, in turn, has distored the demand for hospital care, often encouraging more expensive procedures.

Excessive health benefits are inflationary; they insulate consumers, providers, and insurers from the cost consequences of health care decisions, contributing both to the use of inefficient forms of health care financing and delivery, and to the overuse of health services. A cap would remove the insulation that separates consumers from actual health costs, making them more cost conscious and encouraging them to demand more cost-effective care as well as less costly services.

We share the view held by many that patients, guided by their physicians, demand more services and more expensive services when a large part of their costs are offset by insurance. The combination of private health insurance and public programs such as Medicare and Medicaid now pays for the vast majority of health care services, with patients paying a small fraction of the cost.

While the cap would provide substantial federal revenues, it also would encourage employees to play a more active role in choosing health insurance coverage and to be more sensitive to cost implications in the exercise of that choice. A study conducted by NCHSR found that only 18 percent of Americans receiving health care coverage through employment-related plans now have a choice among plans. If a ceiling were placed on the tax exclusion, many employers probably would make a fixed-dollar contribution toward health insurance while offering employees a choice of plans.

A tax cap would create new incentives for employers to restructure benefit programs and include cost-effective preventive services in their health plans, including services that help reduce unnecessary hospital admissions. For instance, it might provide employers, insurers, unions, and individual workers the opportunity and impetus to: experiment with alternative models of health care delivery, develop benefit packages with built-in incentives toward lower-cost care, develop benefit packages that target the most essential health services, and increase individual accountability for spending on health care. Options ranging from the use of preferred providers and prepaid capitation plans to comprehensive restructuring of the benefit mix may be considered.

FEDERAL SUPPORT FOR HEALTH CARE

Federal resources and commitment, whether through direct grants, appropriations, reimburement for services, or through certain tax policies, all are important factors in the financing of health care. The tax cap proposal, in effect, would reduce the level of federal subsidy to middle- and upper-income individuals by $30 billion over the next four years. Without appropriate adjustments such as the tax cap, an even larger share of federal resources will go toward subsidizing the care of higher-income individuals compared to the poor in the future. For instance, preliminary CBO projections indicate that by 1995, under current law, the federal government will be subsidizing those with employer-based coverage at a rate of $126.8 billion, while the Medicaid program, designed to benefit strictly low-income individuals, is projected to cost $58.4 billion that year by comparison.

NEED TO CONTROL PRIVATE HEALTH CARE SPENDING

The Social Security Amendments of 1983, P.L. 98-21, which enacted prospective payment for inpatient hospital services under Medicare will yield significant program savings. In addition, over the past few years there have been several changes designed to reduce Medicaid growth. As consumers, providers, the Congress, and the federal government continue to grapple with health care cost inflation, the importance of a tax cap becomes even greater. The tax cap is one approach that can have a direct impact on controlling private health care spending, which represents 57 percent of all national health expenditures. Reducing the rate of inflation in health care means addressing not only Medicare and Medicaid, but private health care spending as well.

TAX POLICY CONSIDERATIONS

The current income tax system makes the "price" of health insurance less than the price of other goods and services because employer contributions for health insurance premiums are excluded from employees' taxable income. Employer-provided health insurance, in effect, is purchased at a discount relative to goods and services bought from taxable wages and salaries. The appropriateness of this policy needs to be carefully examined.

In addition, the tax cap would have a progressive impact. The average tax benefit derived under current law is directly related to income—the higher one's income, the larger the tax subsidy for health benefits.

EXISTING COVERAGE

Companies and individuals should have the right to purchase health benefits as they see fit. The proposed limit on tax-exempt employer-provided health benefits, which would affect an estimated 30 percent of the population with employer-based coverage, would be set at a level that would permit complete subsidization of protection against the financial consequences of serious unpredictable illness. Individuals then could purchase additional coverage as desired.

Extensive private group health insurance coverage is readily available for about $2,100 per year or $175 monthly—the levels most commonly discussed in conjunction with a cap. Certain comprehensive health plans provided through the Federal Employees Health Benefits system are but one example of those within these limits that would not be affected by the cap. This coverage includes: full coverage with some copayment and deductible for inpatient hospital care, full coverage at reasonable and customary charge with some copayment and deductible for physician services, and some coverage for prescription drugs.

CONCLUSION

The AHA believes that reducing the rate of inflation in the health care sector requires addressing private health care spending in addition to public programs such as Medicare and Medicaid. Limits on the amount of health benefits provided by employers to employees would help address the private side of the health care cost equation while still providing the opportunity for employees to continue to be protected against the serious financial consequences of illness. The Association appreciates the opportunity to present its views on this matter and looks forward to working with you on legislation in this area.

American Psychiatric Association,
Washington, DC, September 21, 1984.

Hon. Daniel Rostenkowski,
Chairman, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, DC.

Dear Mr. Chairman: The American Psychiatric Association, a medical specialty society representing over 29,000 psychiatrists nationwide, is pleased to provide its views of proposed tax law changes relating to fringe benefits. As you may be aware from previous testimony we have submitted to the House Ways and Means Committee, we are most seriously concerned about past and present efforts to alter the current tax-exempt status of employer-paid employee health insurance premiums.

We know from a recent painful experience with the Federal Employee Health Benefit Plan that when benefits are cut—as they would be in this case to reduce premium costs—the first cutbacks are those for the treatment of mental illness. History has instructed us well that the voiced or unvoiced concerns of the mentally ill, whose benefits under most employer plans already are restricted at best, are not heeded at such times.

Similarly, such a cap could have other serious, but more indirect adverse effects on mentally ill, other chronically ill and older workers. If employers responded to the tax cap by offering employees a choice of plans—a low option which is nontaxable and a high option which is taxable—those who perceive themselves as healthier likely would choose the lower-cost, minimal coverage plan. Less healthy workers would want the protection of a more comprehensive, higher cost (and therefore taxable) plan. Over time, the cost of providing services to the high users would drive up the premium to that group, and those remaining healthier workers would drop out. This adverse selection would put the cost of the more comprehensive protection out of reach for those who need it. Thus, those at greatest risk for high health care costs, for whom the concept of health insurance is intended to serve and who are among the least able to bear the increased tax burden imposed by the tax cap, among them the mentally ill, mentally retarded or handicapped, will be least able to afford the insurance coverage itself.

During Senate Finance Committee hearings on the fringe benefit issue, Chairman Dole noted that "the exclusion from an employee's gross income for employer-provided health care coverage was intended to encourage employers to provide comprehensive medical coverage for all workers. Certainly this desirable social goal has been achieved through the use of tax incentives." He then supported the Administration's proposal to alter such benefit's tax status through the imposition of a cap on such insurance benefits.

We are deeply concerned that changing the current tax status of such health benefits most likely would lead to damaging alterations in that "comprehensive medical coverage" which would work to the detriment of this nation's workers and their families. Further, we understand it will not raise the revenues which the Administration suggests could then be utilized to shore up either the Federal deficit or the Medicare program.

The National Center for Health Services Research, the Employee Benefits Research Institute and Price Waterhouse have all determined that the revenues projected to be raised by the imposition of such a cap are based on poorly founded assumptions. For example, it is assumed that employees will maintain their insurance coverage above a capped level. The facts are to the contrary; employees will opt for lower-cost coverage, avoiding the tax and raising no revenues. As stated at the outset, based on FEHBP experience, benefit packages likely will be reduced to hold down premium costs.

We urge the Committee to retain the current tax status of employer-paid employee health insurance premiums not only because of its hollow promise of increased revenues, but because of the hardship it will work upon a significant number of mentally ill, mentally retarded, handicapped and chronically ill in this country—populations already too often burdened by high insurance premiums for inadequate coverage.

Sincerely,

Jay B. Cutler,
Special Counsel and Director,
Division of Government Relations.

American Society of Association Executives,
Washington, DC, September 19, 1984.

Mr. John J. Salmon,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, DC.

Dear Mr. Salmon: Enclosed for the record of the Hearing To Gather General Information On The Distribution And Economics Of Employer Provided Fringe Benefits are six (6) copies of an excerpt relating to fringe benefits of the Compensation Study that was conducted by the American Society of Association Executives in 1983. Please be aware, however, that because the survey was performed in 1983, it does not reflect the changes to employee benefit plans which have been made to comply with the Tax Equity and Fiscal Responsibility Act of 1982, the Deficit Reduction Act of 1984 and the Retirement Equity Act of 1984.

If I can be of any further assistance, please do not hesitate to give me a call.

Sincerely,

James J. Albertine,
Director of Government Affairs.

Enclosures.

1983
Association Executive Compensation Study

Compiled by
Priestland Associates
Alexandria, Virginia

Published by the
American Society
of Association Executives
1575 Eye Street, N.W.
Washington, D.C. 20005

Section III

Personnel Practices and Fringe Benefits

Observations

The changes in distribution of answers to questions asked in both 1981 and 1983 surveys are attributable at least in part to whatever changes there were in the make-up of the sample. The relationships among associations of various scopes and among the listed alternative responses are similar for both surveys.

Questions new to this survey give additional information to association executives. There is a cash bonus system in less than one-fifth of the reporting associations. Bonuses are based on many criteria, including the following: merit, association budget surplus, performance in department activities, increasing membership, excess of association revenue over annual goal, and others. Bonuses are paid according to various formulae: "in kind," e.g., spouse travel or car allowance; salary levels; and as a means of recognizing good performance after the top of the salary range has been reached.

There were a few changes in the retirement questions in the current survey. Employer cost of the retirement program was broken out to show the cost as a percent of total association payroll and a percent of the payroll of employees covered. There are no clear patterns in these responses among associations by scope of membership. Cost-of-living adjustments for retirees were defined in this survey as "automatic," "ad hoc," or "none." Over two-thirds of the responding associations make no cost-of-living increases for retirees.

In an effort to present the information on medical insurance in a more comprehensive format, we have presented all positive responses without regard to whether coverage was for single plan, family plan, or both. Often, whether or not a person reported the type of plan available depended on marital status. Hospital indemnity insurance was added to the list of medical insurance coverage this year.

A new question on base salary for an entry level clerk was added to this survey. There were only slight variations in the averages and medians, regardless of association characteristics.

Entry Level Clerk—Base Salary

By Type	# of Responses	Average	Median
Trade Associations	525	$10,500	$10,000
Professional Societies	433	10,200	10,000
By Budget			
$200,000 or under	141	10,400	10,000
$200,001–300,000	115	9,800	10,000
$300,001–500,000	154	10,300	10,000
$500,001–750,000	121	10,400	10,000
$750,001–1,000,000	88	10,500	10,000
$1,000,001–2,500,000	193	10,600	10,400
$2,500,001–5,000,000	83	10,300	10,000
$5,000,001–10,000,000	41	10,100	10,000
Over $10,000,000	24	10,100	10,000
By Scope			
National	421	10,800	10,500
State/Regional	405	10,100	10,000
Local	132	9,700	9,600
By Area			
New England	38	10,300	10,000
Middle Atlantic	118	10,000	10,000
East North Central	225	10,200	10,000
West North Central	66	9,700	10,000
South Atlantic	248	10,800	11,000
East South Central	41	9,000	9,000
West South Central	67	10,400	10,000
Mountain	53	9,800	9,600
Pacific	102	11,000	10,800

TABLE 36 Personnel Practices

Analysis of Salary Administration Policies by Association Scope

Position: All Management Personnel

	Total No. of Assns.	% of Total Assns.	National Assns.	% of National Assns.	State/ Regional Assns.	% of State/ Regional Assns.	Local Assns.	% of Local Assns.
Established Salary Structure for Management Personnel:								
Total Respondents	1.129	100%	476	100%	494	100%	159	100%
Salary Grades								
Yes	171	15%	96	20%	59	12%	16	10%
No	877	78%	346	73%	399	81%	132	83%
No Answer	81	7%	34	7%	36	7%	11	7%
Salary Ranges								
Yes	327	29%	177	37%	114	23%	36	23%
No	731	65%	273	57%	345	70%	113	71%
No Answer	71	6%	26	6%	35	7%	10	6%
Types of Salary Increases								
Merit Increases	887	79%	398	84%	365	74%	124	78%
General (across-the-board) Increases	369	33%	139	29%	178	36%	52	33%
Cost-of-Living Increases	448	40%	179	38%	205	42%	64	40%
Length-of-Service Increases	132	12%	51	11%	50	10%	31	20%
Usual Intervals and Timing of Salary Reviews								
Usual Interval								
6 months	47	4%	15	3%	21	4%	11	7%
12 months	966	85%	418	88%	422	86%	126	79%
Other*	6	1%	1	**	4	1%	1	1%
No set interval	33	3%	11	2%	15	3%	7	4%
No Answer	77	7%	31	7%	32	6%	14	9%
Usual Timing								
Anniversary date	261	23%	143	30%	87	18%	31	19%
January 1	293	26%	106	22%	127	26%	60	38%
Fiscal Year	343	31%	123	26%	182	37%	38	24%
Annual Convention	36	3%	23	5%	13	2%	0	0
Other	49	4%	25	5%	19	4%	5	3%
No Answer	147	13%	56	12%	66	13%	25	16%
Cash Bonus System								
For Chief Paid Executive								
Yes	182	16%	69	15%	74	15%	39	25%
No	924	82%	396	83%	409	83%	119	75%
For Second Highest Paid Executive								
Yes	124	11%	51	11%	51	10%	22	14%
No	808	72%	369	78%	335	68%	104	65%
For Department Head								
Yes	116	10%	51	11%	49	10%	16	10%
No	778	69%	360	76%	319	65%	97	61%

*Timed to coincide with beginning of association's fiscal year or annual convention.

**Less than 1%

TABLE 37

Personnel Practices

Analysis of Employment Contracts by Association Scope
Position: Chief Paid Executive, Deputy Chief Paid Executive

	Total No. of Assns.	% of Total Assns.	National Assns.	% of National Assns.	State/ Regional Assns.	% of State/ Regional Assns.	Local Assns.	% of Local Assns.
Chief Paid Executive								
Total Respondents	1.129	100%	476	100%	494	100%	159	100%
Type of Contract								
Formal Contract	330	29%	171	36%	122	25%	37	23%
Letter of Agreement	143	13%	71	15%	54	11%	18	11%
Retained by Resolution of the Board	350	31%	128	27%	173	35%	49	31%
Verbal Arrangement Only	297	26%	100	21%	142	29%	55	35%
Other	6	1%	5	1%	1	**	0	0
Term of Contract								
1 Year	90	8%	44	9%	28	6%	18	11%
2 Years	51	5%	26	5%	18	4%	7	4%
3-4 Years	121	11%	69	15%	39	8%	13	8%
5 Years	47	4%	27	6%	16	3%	4	3%
Over 5 Years	7	1%	4	1%	3	1%	0	0
Continuous Contract	37	3%	15	3%	20	4%	2	1%
Deputy Chief Paid Executive								
Total Respondents	812	100%	371	100%	343	100%	98	100%
Type of Contract								
Formal Contract	46	6%	22	6%	18	5%	6	6%
Letter of Agreement	92	11%	52	14%	33	10%	7	7%
Retained by Resolution of the Board	106	13%	47	13%	49	14%	10	10%
Verbal Arrangement Only	551	68%	240	64%	238	69%	73	75%
Other	17	2%	10	3%	5	2%	2	2%
Term of Contract								
1 Year	36	4%	23	6%	9	3%	4	4%
2 Years	5	1%	4	1%	1	**	0	**
3 Years	17	2%	6	2%	8	2%	3	3%
4-5 Years	1	**	1	**	0	**	0	**
Over 5 Years	0	**	0	**	0	**	0	**
Continuous Contract	10	1%	6	2%	4	1%	0	**

**Less than 1%

TABLE 37

Continued

Personnel Practices

Analysis of Employment Contracts by Association Scope
Position: Chief Paid Executive, Deputy Chief Paid Executive

	Total No. of Assns.	% of Total Assns.	National Assns.	% of National Assns.	State/ Regional Assns.	% of State/ Regional Assns.	Local Assns.	% of Local Assns.
Contract clause allowing association to terminate before the specified number of years								
Chief Paid Executive								
Yes	251	22%	127	27%	95	19%	29	18%
No	129	11%	71	15%	40	8%	18	11%
Deputy Chief Executive								
Yes	41	5%	20	5%	14	4%	7	7%
No	51	6%	24	6%	22	6%	5	5%
Length of notice to be given								
Chief Paid Executive								
1 month	42	4%	17	4%	16	3%	9	6%
2 months	36	3%	11	2%	19	4%	6	4%
3 months	83	7%	40	8%	34	7%	9	6%
4 months	9	1%	6	1%	3	1%	0	**
6 months	80	7%	52	11%	20	4%	8	5%
9-11 months	1	**	1	**	0	**	0	**
12 months	24	2%	15	3%	9	2%	0	**
Deputy Chief Executive								
1 month	21	3%	8	2%	8	2%	5	5%
2 months	5	1%	2	1%	2	1%	1	1%
3 months	12	1%	8	2%	3	1%	1	1%
4 months	3	**	2	1%	1	**	0	**
6 months	7	1%	5	1%	2	1%	0	**

**Less than 1%

TABLE 38 Personnel Practices

Analysis of Employment Experience by Association Scope
Position: Chief Paid Executive, Deputy Chief Paid Executive

	Total No. of Assns.	% of Total Assns.	National Assns.	% of National Assns.	State/ Regional Assns.	% of State/ Regional Assns.	Local Assns.	% of Local Assns.
Chief Paid Executive								
Total Respondents	1.129	100%	476	100%	494	100%	159	100%
Number of years in present position								
1*-2	183	16%	92	19%	71	14%	20	13%
3-5	277	25%	114	24%	115	23%	48	30%
6-9	210	19%	80	17%	101	20%	29	18%
10-14	233	21%	96	20%	112	23%	25	16%
15-19	94	8%	37	8%	43	9%	14	9%
20-29	104	9%	43	9%	43	9%	18	11%
30 or more	13	1%	5	1%	6	1%	2	1%
No Answer	15	1%	9	2%	3	1%	3	2%
Previous Position								
Current Association (different capacity)	222	20%	108	23%	95	19%	19	12%
Another Association	388	34%	155	33%	172	35%	61	38%
Government	104	9%	34	7%	58	12%	12	8%
Military	25	2%	13	3%	7	1%	5	3%
Private Industry	253	22%	103	22%	108	22%	42	26%
Self-employed Professional	41	4%	16	3%	16	3%	9	6%
Educational Institution	80	7%	39	8%	34	7%	7	4%
Other	12	1%	6	1%	3	1%	3	2%
No Answer	4	**	2	**	1	**	1	1%
Deputy Chief Executive								
Total Respondents	812	100%	371	100%	343	100%	98	100%
Number of years in present position								
1*-2	238	29%	100	27%	109	32%	29	30%
3-5	222	27%	90	24%	101	30%	31	32%
6-9	153	19%	71	19%	65	19%	17	17%
10-14	108	13%	61	16%	36	10%	11	11%
15-19	43	5%	21	6%	16	5%	6	6%
20-29	37	5%	21	6%	14	4%	2	2%
30 or more	3	**	2	1%	1	**	0	0
No Answer	8	1%	5	1%	1	**	2	2%
Previous Position								
Current Association (different capacity)	145	18%	76	20%	54	16%	15	16%
Another Association	141	17%	77	21%	50	15%	14	14%
Government	92	11%	25	7%	58	17%	9	9%
Military	14	2%	4	1%	7	2%	3	3%
Private Industry	281	34%	127	34%	111	32%	43	44%
Self-employed Professional	30	4%	12	3%	14	4%	4	4%
Educational Institution	79	10%	39	11%	35	10%	5	5%
Other	25	3%	11	3%	9	3%	5	5%
No Answer	5	1%	0	**	5	1%	0	**

*Includes less than one year.

**Less than 1%

TABLE 39 Fringe Benefits

Analysis of Retirement Benefits by Association Scope
Position: All Management Personnel

	Total No. of Assns.	% of Total Assns.	National Assns.	% of National Assns.	State/ Regional Assns.	% of State/ Regional Assns.	Local Assns.	% of Local Assns.
Total Respondents	1,129	100%	476	100%	494	100%	159	100%
Types of Retirement Plans*								
IRS Qualified Retirement Plan(s)	518	46%	248	52%	210	43%	60	38%
IRS Qual. & Deferred Comp. Plan	80	7%	37	8%	32	6%	11	7%
Deferred Compensation Plan(s)	82	7%	33	7%	38	8%	11	7%
Individual Retirement Acct. (IRA)	115	10%	34	7%	58	12%	23	14%
Tax Sheltered Annuity (TSA)	94	8%	52	11%	28	6%	14	9%
Other	60	5%	20	4%	29	6%	11	7%
None (no plan)	195	17%	63	13%	99	20%	33	21%
No Answer	18	2%	8	2%	8	2%	2	1%
Plan is:								
Defined Benefit Plan	347	37%	178	43%	133	34%	36	28%
Defined Contribution Plan	429	46%	179	43%	181	46%	69	55%
No Answer	158	17%	56	14%	81	20%	21	17%
Eligibility								
At age:								
21 and below	35	4%	11	3%	16	4%	8	6%
22-24	47	5%	22	5%	22	6%	3	2%
25	176	19%	98	24%	60	15%	18	14%
26-30	8	1%	6	1%	2	1%	0	**
And/or after:								
1 year's employment	249	27%	128	31%	95	24%	26	21%
2 years' employment	21	2%	9	2%	10	3%	2	2%
3 years' employment	58	6%	25	6%	22	6%	11	9%
4-5 years' employment	23	2%	14	3%	6	2%	3	2%
Vesting								
100% immediate	196	21%	87	21%	73	18%	36	29%
Graded 100% in:								
Less than 10 years	129	14%	57	14%	56	14%	16	13%
10 years	177	19%	91	22%	72	18%	14	11%
11-15 years	97	10%	48	12%	36	9%	13	10%
Cliff vesting: 100% after 10 yrs.	160	17%	66	16%	74	19%	20	16%
Other	13	1%	9	2%	4	1%	0	**
No Answer	358	38%	119	29%	178	45%	61	48%

*Adds to more than 1,129 because of multiple plans.
**Less than 1%

TABLE 39

Continued

Fringe Benefits

Analysis of Retirement Benefits by Association Scope
Position: All Management Personnel

	Total No. of Assns.	% of Total Assns.	National Assns.	% of National Assns.	State/ Regional Assns.	% of State/ Regional Assns.	Local Assns.	% of Local Assns.
Retirement age Normal retirement at: Under 62	24	3%	9	2%	12	3%	3	2%
62	16	2%	6	1%	6	2%	4	3%
65	654	70%	318	77%	258	65%	78	62%
70	11	1%	4	1%	5	1%	2	2%
Other ages	2	**	1	**	1	**	0	**
Early retirement at: Under 55	14	2%	6	1%	6	2%	2	2%
55	240	26%	132	32%	82	21%	26	21%
60	58	6%	26	6%	28	7%	4	3%
62	83	9%	38	9%	34	9%	11	9%
Other ages	22	2%	8	2%	7	2%	7	6%
Length of Service Requirement Maximum Benefit: Years of Service Under 10	48	5%	21	5%	22	6%	5	4%
10	157	17%	75	18%	67	17%	15	12%
11-15	75	8%	41	10%	28	7%	6	5%
20	53	6%	29	7%	20	5%	4	3%
25	14	2%	8	2%	5	1%	1	1%
Over 25	42	5%	22	5%	17	4%	3	2%
Early Retirement Years of Service Under 10	45	5%	23	6%	16	4%	6	5%
10	149	16%	80	19%	56	14%	13	10%
11-15	32	3%	19	5%	10	3%	3	2%
Over 15	30	3%	12	3%	16	4%	2	2%
Minimum Benefit Years of Service 5 or less	146	16%	78	19%	54	14%	14	11%
6-10	60	6%	29	7%	26	7%	5	4%
Over 10	5	1%	5	1%	1	**	0	**
Benefit reduction for early retirement Yes	438	47%	221	54%	173	44%	44	36%
No	231	25%	93	22%	97	24%	41	32%
No Answer	265	28%	99	24%	125	32%	41	32%
Funding and Payment Percent of retirement program cost paid by the association 50% or less	18	2%	11	3%	5	1%	2	2%
51-99%	52	6%	31	8%	19	5%	2	2%
100%	677	72%	303	73%	287	73%	87	69%

**Less than 1%

TABLE 39

Continued

Fringe Benefits

Analysis of Retirement Benefits by Association Scope

Position: All Management Personnel

	Total No. of Assns.	% of Total Assns.	National Assns.	% of National Assns.	State/ Regional Assns.	% of State/ Regional Assns.	Local Assns.	% of Local Assns.
Employer cost of program as % of total association payroll								
3% or less	67	7%	35	8%	19	5%	13	10%
4-5%	88	9%	40	10%	38	9%	10	8%
6-7%	92	10%	48	12%	39	10%	5	4%
8-9%	81	9%	43	10%	32	8%	6	5%
10%	80	9%	30	7%	43	11%	7	6%
11-15%	84	9%	38	9%	33	8%	13	10%
Over 15%	29	3%	14	3%	13	3%	2	2%
Employer cost of program as % of payroll of employees covered								
6% or less	104	11%	47	11%	40	10%	17	13%
7-9%	127	14%	72	17%	44	11%	11	9%
10%	105	11%	47	11%	46	12%	12	10%
11-14%	73	8%	30	7%	31	8%	12	10%
Over 14%	80	9%	41	10%	34	9%	5	4%
Retirement benefit adjusted automatically for cost-of-living increases for retirees	40	4%	19	5%	18	5%	3	2%
Retirement benefit adjusted on an ad hoc basis for cost-of-living increases for retirees	39	4%	17	4%	18	5%	4	3%
No cost-of-living increases are currently made for retirees	644	69%	305	74%	259	66%	80	63%
Retirement benefit integrated with social security benefit								
Yes	326	35%	155	38%	133	33%	38	30%
No	468	50%	211	51%	196	50%	61	48%
No Answer	140	15%	47	11%	66	17%	27	22%
Pre-retirement spouse's benefit								
Yes	190	20%	97	23%	77	19%	16	13%
No	578	62%	255	62%	240	61%	83	66%
No Answer	166	18%	61	15%	78	20%	27	21%
If yes, is it:								
Contributory	15	8%	10	10%	3	4%	2	13%
Funded by the association	159	84%	78	81%	69	90%	12	76%
No Answer	16	8%	9	9%	5	6%	2	13%
Employees can make additional voluntary contributions to the plan								
Yes	455	49%	221	54%	178	45%	58	44%
No	352	38%	150	36%	153	39%	49	39%
No Answer	127	13%	42	10%	64	16%	21	17%

**Less than 1%

TABLE 40 Fringe Benefits

Analysis of Life & Accident Insurance by Association Scope
Position: All Management Personnel

	Total No. of Assns.	% of Total Assns.	National Assns.	% of National Assns.	State/ Regional Assns.	% of State/ Regional Assns.	Local Assns.	% of Local Assns.
Total Respondents	1,129	100%	476	100%	494	100%	159	100%
Basic Life Insurance Coverage Yes	967	86%	423	89%	415	84%	129	81%
No	152	13%	46	10%	76	15%	30	19%
No Answer	10	1%	7	1%	3	1%	0	0
Maximum amount Under $50,000	371	38%	141	33%	166	40%	64	50%
$50,000 or above	572	58%	271	64%	239	58%	62	48%
No Answer	24	2%	11	3%	10	2%	3	2%
Schedule is determined by Salary	495	51%	235	56%	206	50%	54	42%
Job classification	220	23%	85	20%	104	25%	31	24%
Both	101	11%	52	12%	39	9%	10	8%
Other	120	12%	43	10%	50	12%	27	21%
No Answer	31	3%	8	2%	16	4%	7	5%
If by salary, amount is Under 2 times salary	310	52%	141	49%	133	54%	36	56%
2 times salary or more	271	45%	135	47%	110	45%	26	41%
No Answer	15	3%	11	4%	2	1%	2	3%
% of premium paid by association 100%	910	94%	395	93%	394	95%	121	94%
Under 100%	27	3%	15	4%	9	2%	3	2%
No Answer	30	3%	13	3%	12	3%	5	4%
Accidental Death and Dismemberment Coverage Yes	822	73%	369	77%	351	71%	102	64%
No	282	25%	93	20%	135	27%	54	34%
No Answer	25	2%	14	3%	8	2%	3	2%
If yes, is it included in life insurance policy Yes	548	67%	251	68%	226	64%	71	70%
No	226	27%	95	26%	107	31%	24	23%
No Answer	48	6%	23	6%	18	5%	7	7%
Maximum coverage is Under $100,000	395	48%	158	43%	182	52%	55	54%
$100,000-$150,000	239	29%	112	30%	100	28%	27	26%
Over $150,000	143	17%	83	23%	44	13%	16	16%
No Answer	45	6%	16	4%	25	7%	4	4%
% of premium paid by association 100%	748	91%	331	90%	325	93%	92	90%
Under 100%	30	4%	13	3%	12	3%	5	5%
No Answer	44	5%	25	7%	14	4%	5	5%
Association provides travel accident coverage Yes	666	59%	327	69%	268	54%	71	45%
No	442	39%	139	29%	218	44%	85	53%
No Answer	21	2%	10	2%	8	2%	3	2%

**Less than 1%

TABLE 41 Fringe Benefits

Analysis of Long-Term Disability Insurance by Association Scope
Position: All Management Personnel

	Total No. of Assns.	% of Total Assns.	National Assns.	% of National Assns.	State/ Regional Assns.	% of State/ Regional Assns.	Local Assns.	% of Local Assns.
Total Respondents	1.129	100%	476	100%	494	100%	159	100%
Association provides a long-term disability plan								
Yes	755	67%	334	70%	324	66%	97	61%
No	352	31%	134	28%	158	32%	60	38%
No Answer	22	2%	8	2%	12	2%	2	1%
If yes, after total disability, benefits commence in								
30 days or less	198	26%	69	21%	96	30%	33	34%
60 days	120	16%	52	15%	53	16%	15	15%
90 days	249	33%	107	32%	115	35%	27	28%
Over 90 days	157	21%	92	28%	47	15%	18	19%
Other	14	2%	8	2%	4	1%	2	2%
No Answer	17	2%	6	2%	9	3%	2	2%
Duration of the payments for accidents is								
Less than five years	83	11%	33	10%	31	10%	19	20%
5-10 years	68	9%	25	7%	31	10%	12	12%
Over 10 years	15	2%	2	1%	12	3%	1	1%
To age 65*	357	47%	177	53%	143	44%	37	38%
For life	189	25%	79	24%	90	28%	20	21%
No Answer	43	6%	18	5%	17	5%	8	8%
Duration of the payments for illness is								
Less than five years	93	12%	34	10%	39	12%	20	21%
5-10 years	72	10%	25	7%	32	10%	15	15%
Over 10 years	12	2%	2	1%	9	3%	1	1%
To age 65*	342	45%	177	53%	131	40%	34	35%
For life	137	18%	56	17%	64	20%	17	18%
No Answer	99	13%	40	12%	49	15%	10	10%
Payments are integrated with Social Security								
Yes	335	44%	152	46%	143	44%	40	41%
No	388	52%	168	50%	169	52%	51	53%
No Answer	32	4%	14	4%	12	4%	6	6%
Benefits as % of salary								
Over 60%	213	28%	75	22%	109	34%	29	30%
50%-60%	352	47%	176	53%	133	41%	43	44%
Less than 50%	131	17%	60	18%	58	18%	13	14%
No Answer	59	8%	23	7%	24	7%	12	12%
% of premium paid by association								
100%	701	93%	306	91%	302	93%	93	96%
Less than 100%	36	5%	19	6%	15	5%	2	2%
No Answer	18	2%	9	3%	7	2%	2	2%

*Occasionally reported to age 70.
**Less than 1%

TABLE 42 Fringe Benefits

Analysis of Medical Insurance by Association Scope

Position: All Management Personnel

	Total No. of Assns.	% of Total Assns.	National Assns.	% of National Assns.	State/ Regional Assns.	% of State/ Regional Assns.	Local Assns.	% of Local Assns.
Total Respondents	1,129	100%	476	100%	494	100%	159	100%
Association provides medical insurance								
Yes	1,076	95%	455	96%	474	96%	147	92%
No	48	4%	19	4%	17	3%	12	8%
No Answer	5	-1%	2	**	3	1%	0	**
If yes, types of coverage								
Basic Hospitalization/Surgical	856	80%	378	83%	368	78%	110	75%
Major Medical	999	93%	424	93%	442	93%	133	90%
Health Maintenance Organization	134	12%	63	14%	51	11%	20	14%
Direct medical expense payments	118	11%	50	11%	50	11%	18	12%
Dental Insurance	459	43%	215	47%	180	38%	64	44%
Hospital Indemnity Insurance	53	5%	20	4%	28	6%	5	3%
% of total medical insurance cost paid by the association								
Single plan								
100%	608	57%	272	60%	256	54%	80	54%
51%-99%	51	5%	34	7%	15	3%	2	1%
50%	11	1%	7	2%	2	**	2	1%
Below 50%	3	**	2	**	0	**	1	1%
Family plan								
100%	601	56%	227	50%	293	62%	81	55%
51%-99%	109	10%	73	16%	28	6%	8	5%
50%	28	3%	17	4%	8	2%	3	2%
Below 50%	90	8%	41	9%	35	7%	14	10%

**Less than 1%

Statement of American Telephone & Telegraph Co.

AT&T is pleased to submit this testimony in connection with the House Ways and Means Committee's hearings on the tax treatment of pensions and other employee benefits and for the opportunity for a full and open hearing on this important subject.

With regard to Representative Pickle's questions, AT&T has reviewed the answers formulated by the Employee Benefit Research Institute (EBRI) and believes that its answers present a fair discussion of employee benefits, the implications of various types of tax treatment relative to these benefits, and the complementary nature of government benefit programs and those provided by the private sector. Much of the data and statistics presented by EBRI speaks for itself—millions of Americans at all income levels are covered by employee benefit programs and the existing rules concerning employee benefits ensure that all of these employees benefit fairly from the tax incentives provided under current law.

Relative to pension policy, AT&T is concerned with the disincentives for defined benefit plans, which seem to be the trend in public policy. Public policy is being driven more by short-term considerations and problems than concern for the long-term implications. It is true that the federal deficits must be reduced. But the policy in regard to pensions should take a long-term view and not a short-term one. Finally, we have some other specific concerns regarding defined benefit pension plans—specifically integration and the plan termination insurance program.

In 1913, at a time when fewer than 100 private pension plans had been established in the United States, AT&T designed and adopted defined benefit pension plans covering its 150,000 Bell System employees. The primary motives were based on considerations of sound business practice. The establishment of the plans was judged to be an effective solution to deal with the problem of an aging population, a way of managing the systematic retirement of employees, while providing the retirees a continuing income to assist in meeting their financial needs. As a social purpose, it was believed that in order to minimize the economic adjustments necessitated by the retirement of an individual from active service, the retirement income should bear some reasonable relationship to income earned during active employment and thus the pension benefit defined by the plans was based on a percentage of final 10-year pay.

Originally, all costs of the plans were met on a pay-as-you-go basis. During the first 14 years of operation of the plans, pension expense was set equal to pension payments as such payments were made. During this period, there was no advance funding of pensions as that concept is commonly known today. By the early 1920s, however, it was obvious that because of the increasing pension roll, the pension payments as a percentage of payroll were increasing dramatically, and, if a sound financial program were not instituted, the result would be a significant cost deferral and a drain on future business operations, which could result in a termination of the plan or a drastic reduction of benefits. Clearly, this approach provided far less benefit security to employees than advance funding.

AT&T began intensive actuarial studies of the plans, together with related accounting, financial and legal questions. As a result of these studies, the conclusion was reached that benefits, other than retirement income benefits, could continue to be financed satisfactorily on a pay-as-you-go basis, but that service pensions should be placed on an actuarial basis with advance funding and segregated assets, an "off balance sheet" concept. An actuarial accrual plan was adopted in 1927 and evolved over the years to a plan where pensions and death benefits are now funded on a full accrual basis.

The evolution of AT&T's pension plan and funding program, as well as that of other companies, occurred during a time when there was minimal regulation regarding pensions. However, in an environment of sharply increased regulation, companies would be less willing to establish and maintain pension plans since they would have little flexibility in the funding of these plans.

Over the years, in order for our pension benefits to keep pace with others in industry, the benefit was improved many times, including the change from a 10-year to 5-year final pay formula in 1959, and the elimination of a direct Social Security offset. Our pension benefit remained among the country's best, and pension accrual costs increased significantly with each improvement. With the high inflation of the seventies, the benefit formula was further improved, and, from 1959 to 1979, pension accrual costs had risen from a level of about 6% of payroll to nearly 18% of a payroll which was also increasing each year. In addition to improvements through plan amendments, under the final pay formula pension benefit levels were improving automatically as pay escalated to a point where, in some instances, the combination of the pension benefit and Social Security exceeded pre-retirement disposable income.

At that point in 1979, a re-evaluation of the pension benefit structure was undertaken and changes made which would give the Company more control in benefit levels. These changes were designed such that benefits would not automatically increase with inflation. Since costs are a function of benefits, by first controlling benefits, the Company would be able to have some control over the costs of the plan. The result of the redesign of the benefit structure was a lowering of the Company's pension cost as a percent of pay. AT&T's action was not unique. Even though pension contributions are tax deductible, companies have and will take action to lower pension costs if those costs become too high relative to industry in general.

In October 1980 the plans of the individual Bell System companies were consolidated into two national pension plans covering all Bell System employees. The bargained-for plan for non-management employees adopted a pension formula not directly related to final pay, a so-called "flat-dollar" plan. Under this flat-dollar plan, the monthly pension is determined by multiplying years of service by a dollar amount based on job classification. This structure has the advantage of giving the company the flexibility of agreeing to plan improvements at an appropriate time rather than benefit increases occurring automatically through salary increases. The plan adopted covering management employees was an adjusted career average pay plan. This structure also permits management control on future benefit levels and costs while initially providing improved benefits relative to the former formula.

Today the management and non-management plans of the post-divestiture AT&T cover approximately 370,000 active and 60,000 retired participants, ranging in ages from 25 to over 100. The benefit formulas in both plans have been improved since 1980 and today a manager retiring under the management plan at 65 with 35 years of service receives a pension benefit from the plan of just over 40% of final pay. Together with Social Security, the retirement income averages almost 65% of the employee's last year's wages. Under the non-management plan, a craftsman retiring at the same age and service also receives a pension of about 40% of final pay, which, together with Social Security, produces a total retirement income of about 70% of final pay. Supplementing the defined benefit plans are defined contribution savings plans. Our policy is that retirement income is best provided by a defined benefit vehicle, although a defined contribution savings plan can provide a supplement.

DEFINED BENEFIT AND DEFINED CONTRIBUTION PLANS

Many things have changed since 1913, but the purposes served by a pension plan are still both business and social in nature. A plan should be designed so as to attract and retain employees by providing an assurance of a retirement benefit which, together with Social Security, will provide a retirement benefit which bears a reasonable relationship to pre-retirement income. Of course, this concept of reasonableness is a matter of company policy and affordability.

The delivery of the pension benefit can be provided either through a defined benefit or a defined contribution plan. However, the advantages of a defined benefit plan in providing retirement income within the framework of a sound financial program far outweigh any strengths a defined contribution plan might appear to have. The employer community has recognized these advantages as evidenced by the popularity of the defined benefit plans as a retirement income vehicle. Clear preference over the last several decades for defined benefit plans argues strongly for their superiority in providing retirement income over defined contribution plans.

Under a defined benefit plan, retirement income is definitely determinable as a percentage replacement of pay and, through the plan formula, income levels near retirement can be reflected in the pension benefit. Defined benefit plans can provide credit for past service and thus permit the replacement of increases in employee salary levels resulting from promotions or from an inflationary environment prior to retirement (such as we have experienced during the last 15 years). In addition, since the employer assumes the risk of poor investment performance, employees are insulated from such risk. Finally, for a retired employee covered by a defined benefit plan, the erosion of the pension benefit due to inflation is avoidable since the employer may help insulate retirees from their decreased buying power via ad-hoc pension benefit increases.

Under defined contribution plans, on the other hand, retirement income is not definitely determinable, and the amount can vary depending on investment earnings during the accumulation period and the condition of the securities markets at the time of retirement. For example, if an employee had retired during the period

1974 to 1975 under a defined contribution plan when the securities market was depressed, the amount of accumulation in that individual's account would have been significantly eroded, impacting on his retirement security. Since it is extremely difficult to provide credit for past service with this type of plan, any promotional or inflation make-up salary increases cannot be fully reflected in retirement income levels. An employee covered by a defined contribution plan faces a retirement income which is uncertain at best without the possibility of benefit adjustments to insulate the individual from the effects of inflation. The result of a fixed employer contribution as a percentage of payroll is that contributions which would be adequate for older employees would be excessive for younger employees, and contributions which would be adequate for younger employees would be less than adequate for older employees—hardly an equitable system.

It is important to note that the role played by defined benefit plans is a vital one, and the formation, growth, and stability of these plans must be encouraged if employees are to have any guarantee of retirement income security. With a defined contribution plan as the primary vehicle for providing pensions, inflation can destroy the security of retirement income. Provisions of recent legislation—TEFRA and the Deficit Reduction Act—have generally discouraged the maintenance of defined benefit plans. The objective of current policy has been to eliminate perceived abuses in defined benefit plans and also to decrease tax expenditures. AT&T agrees that the elimination of abuses is appropriate. However, any policy which focuses on reducing tax expenditures without considering the long-term ramifications on retirement income security of American workers may prove to be inappropriate long-term policy. Legislation and tax proposals in the pension area should encourage employers to provide benefits to meet the retirement security needs of employees through defined benefit plans.

TAX DEFERRAL VS. TAX SHELTER

The growth of employee benefits has caused much concern to policymakers in the last few years because of their tax-favored treatment, and the resultant losses of federal tax revenues to the government. Another concern is the abuse of tax deferral rules leading to the rise of pension plans as mere tax shelters. Concern about the federal deficit has caused many to interpret the growth of tax-favored benefits as an erosion of the tax base, and a threat to the public sectors's ability to finance government programs. Tax policy seems to be excessively concerned with current tax expenditures at the expense of sounder long-term policy. There is no question that it is important to distinguish between bona fide corporate pension arrangements and arrangements where the pension plan is used as a vehicle to avoid current taxation on a significant portion of income. Use of the pension plan as a vehicle for tax shelter should, of course, not be permitted. On the other hand, the tax deferral of employer pension contributions provides incentives for employers to provide for retirement income.

In most instances, determining whether or not a pension plan is being used as a vehicle for tax shelter should not be a difficult process. As a general rule, in major corporations, key employees are a very small percentage of the total employee population and the percentage of total contributions made on behalf of key employees is small. And, since benefit plan contributions are ultimately paid out as taxable benefits, these contributions will ultimately be part of the tax base at a later date. On the other hand, if the percentage of total contributions made on behalf of key employees is significant (e.g. 50%), then perhaps the plan is being used as a tax shelter.

If pension plans are to provide benefits over a long future period, there must be a sound financial program for meeting these obligations. Advance funding provides the means of insuring the benefit security of employees and current retirees, resulting in less reliance on public programs. In addition, pension plan contributions represent a form of savings in the economy. Corporate plans have created a large source of funds for investments. Pension assets backing private plans (including those funded with life insurance companies) in the U.S. reached $680 billion at the end of 1983, an increase of almost fivefold in the amount of assets from the end of 1970. This substantial increase in assets was, of course, tied to large increases in liabilities. A good part of those increases was attributable to the inflation of the 1970s. Without these pension assets, under a pay-as-you-go funding program, the cost of capital would be higher due to an increased demand for funds.

The problems created by pay-as-you-go financing are exemplified by our Social Security system. The Social Security program was designed to operate on a pay-as-you-go basis with a trust fund to serve as a cushion so that benefits could be paid in economic conditions where expenditures exceeded income. By the mid-1970s, it became apparent that the program was being seriously underfinanced. Changes in Social Security law in 1977 were designed to correct the system's short-term financing problems and some of the long-range problems by increasing payroll tax revenues and adjusting initial Social Security benefit levels. The problems which the Social Security System has experienced should not be compounded by forcing the underfunding of the private pension system.

FINANCING ARRANGEMENTS

Tax policy toward pension plans should encourage funding to meet the ultimate obligations for benefits. With the increasing cost of Social Security and the emerging decline in the ratio of workers to retirees, the stability of private pension plans is even more important. Thus, tax policy regarding pension plans should be established with a long-term perspective; it should not change frequently and dramatically. Pension plans are long-term arrangements that call for financing over long periods of time, and frequent changes in tax policy make it very difficult for employers to design and maintain their plans.

To insure adequate funding in specific instances, tax policy should also encourage faster funding than currently required in the cases of "poorly funded" plans. For example, a recent survey by a large consulting firm revealed that about 70% of flat-dollar plans are less than 100% funded for accrued benefits. Of those, more than one-fifth are less than 50% funded. We would consider a mature plan with an accrued benefit security ratio of less than 50% to be poorly funded.

One final technical point—actuarial gains and losses of an extraordinary nature should be permitted to be immediately reflected in the funding.

MAXIMUM BENEFIT LIMITATIONS

The concept of maximum benefit limitations (currently $90,000 on employees' benefits) is frequently misunderstood. Limits on benefits were originally established to deal with professional organizations and plans which were being used as tax shelters. The concern which we have now is that these limits could impact middle income employees if such limits are not indexed properly. Also, employees affected by these benefit limitations make company pension policy, and these employees could possibly decide to curtail funding or terminate a plan to the detriment of others if the plan provides limited benefit payments to such affected employees. Limits lead to more limited funding of plans, and the impact is significant over time. The question that should be asked is why there should be limits if a plan is not discriminatory.

With regard to the effect of the limits on the tax deduction for contributions, in the plans of most corporations where key employees are a small percentage of the work force, the impact on corporations' total tax liability is small. The possibility of abuse is greatest in "tax shelter" plans and it is in these plans that the limits should be applied. Another alternative is to not allow a deduction for employer contributions when made if the contributions are for benefits above the limit for deductible amounts, but to allow the tax deduction of the benefit amounts when they are actually paid from the plan.

As indicated earlier, we have two other specific issues in regard to pension policy which we would like to address—single employer plan termination insurance and Social Security integration.

SINGLE EMPLOYER PLAN TERMINATION INSURANCE

In order for plan termination insurance to better serve the purpose for which it was initially established under Title IV of ERISA—the protection of plan participants in the event of plan termination—certain changes should be made. AT&T supports the linkage of any premium increase with reform in Title IV. Specifically, the term "insurable event" should be redefined so as to prevent the dumping of private pension plan liabilities of ongoing businesses onto the PBGC. In addition, premiums should be risk-related as in other forms of insurance. Companies with poorly funded plans who are more likely to use the benefits such insurance provides should pay proportionately more than better funded, more stable plans. Furthermore, AT&T believes that some form of contingent liability should be incorporated into the single employer plan termination insurance program with respect to spinoffs, mergers, sale of assets, etc. Finally, an advisory committee should be established to monitor PBGC administration of Title IV—including premium requirements.

SOCIAL SECURITY INTEGRATION

Regulations regarding Social Security integration should be brought up to date and be based on a benefit delivery basis, not a presumptive cost basis. Currently, these regulations impair proper benefit design. The current rules are also out of date with respect to the benefits provided by Social Security. The redesigned Social Security benefits should be taken into account in developing future regulations on integration. In its paper on integration, the Society of Actuaries' Committee on Pensions sets forth a view based on benefit delivery, and regulations should support this view. Discrimination in integrated plans could be defined as providing retirement income which is a greater percentage of pay to higher paid than to lower paid employees.

AMERITECH,
Chicago, IL, September 18, 1984.

Hon. J. J. PICKLE,
Hon. FORTNEY H. STARK,
Committee on Ways and Means, House of Representatives,
Washington, DC.

DEAR MR. PICKLE AND MR. STARK: I submit this to the Subcommittees on Social Security and Select Revenue Measures of the Committee on Ways and Means concerning employer provided fringe benefits at Ameritech.

The figures provided are estimates derived from previous AT&T split outs.

The latest data were from 1981-1982, but continue to be representative of current conditions. Benefit costs have remained relatively stable since 1976 in the AT&T system.

(1) What is the total cost of benefits provided to employees?

(2) What percentage of total compensation does the total cost of benefits represent?

Estimated Total Compensaton (1981) was $2,900,000,000

Benefit costs were about 27.81% of total compensation or almost $807,000,000

This does not include vacation pay, holiday pay and other paid time off.

The following represent tax free benefits:

	Percent
Group Life	.66
Medical	5.41
Dental	.81
Other	.41
Total	[1] 7.29

[1] Or about $210,000,000.

And the following represent tax deferred benefits:

	Percent
Pension	13.16
Savings	1.69
Total	[1] 14.85

[1] Or about $430,000,000.

(4) What percentage of total compensation and total cost of benefits does the cost of tax free and tax deferred benefits represent?

Percentage of total compensation

	Percent
Tax free benefits	7.29
Tax deferred benefits	14.85
Total	22.14

Percentage of total cost of benefits: (1) Tax free plus tax deferred benefits are 22.14% of pay; (2) Total benefits (including Social Security) are 27.81% of pay; and (3) Percentage of benefits which are tax free and tax deferred is 79.61% (1+2).

(5) What is per employee cost of both the total benefits provided and each type of benefit?

There were approximately 104,000 employees in 1981. The per employee cost was about $7,800 ($807,000,000 divided by 104,000 employees)

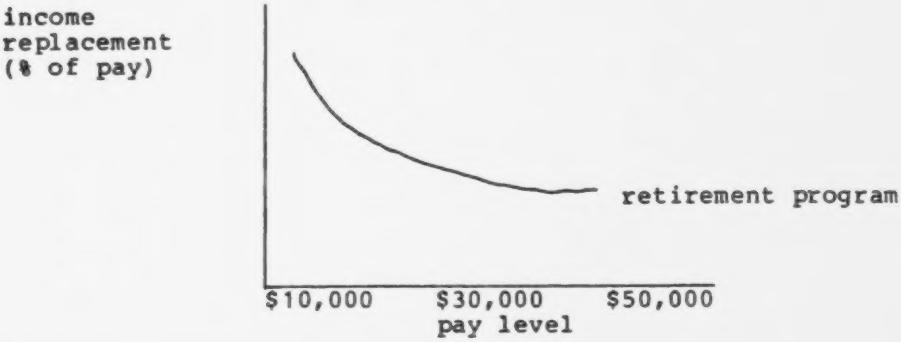
Each type of benefit cost was:

	Percentage of pay costs	Estimated per employee costs
Total gross payroll	100.0	$28,000
Fringe payments—outside payroll:		
Pension and death benefits	13.16	3,700
Group life	.66	200
Medical	5.41	1,500
Dental	.81	200
Savings	1.69	500
Other	.41	100
Social Security	5.67	1,600
Total fringe—outside payroll	27.81	7,800

Ameritech's retirement program consists of: Defined Benefit Plan; Savings Plan; and Social Security

The defined benefit and savings plans are not integrated with Social Security and provide the same percentage of income replacement for all employees.

On the other hand, Social Security replaces more income for the lower dollars of pay then it does for the higher dollars up to the maximum taxable wage base. Thus, Social Security provides greater income replacement for the lower paid. Graphically, this looks as follows:



(6) What percentage of the employee's salaary does the cost of the benefits provided represent?

As stated above, approximately 28% for all benefits. Only 7.29% is for tax free benefits.

(7) What benefits are provided to employees in various salary ranges?

We do not keep records in this format.

Medical benefits and dental benefits are not pay related. They are available to all employees. Consequently, medical benefits will be a higher percentage of pay for the lower paid employee.

The other fringe benefits are pay related. All employees receive coverage in the same relation to their pay.

It is estimated that the range of benefits provided as a percentage of pay is as follows:

Pay	*Percentage of Pay*
$10,000	32
30,000	22
50,000	20
100,000	18

(8) Are any benefits provided through a cafeteria plan?

No. But this concept is attractive to Ameritech in providing benefits better suited to employees' needs.

Yours very truly,

DONALD W. PHILLIPS,
Director, Investment Management.

JOINT STATEMENT OF THE AMERICAN COUNCIL OF LIFE INSURANCE AND THE HEALTH INSURANCE ASSOCIATION OF AMERICA (HIAA).

This statement on employee benefits is submitted on behalf of the American Council of Life Insurance (Council) and the Health Insurance Association of America (HIAA). The Council has a membership of 611 life insurance companies which, in the aggregate, have 95 percent of the life insurance in force in the United States and hold 99 percent of the assets of insured pension plans. The HIAA has 320 members which write over 85 percent of the commercial accident and health insurance in the United States. Most of the members of the Council are also in the business of accident and health insurance.

Our statement will serve to document the vitally important role employee benefits play in providing economic security to hundreds of millions of American workers, their beneficiaries and retirees. In recent years, Congress seems to have lost sight of this fact. It has enacted major legislation affecting employee benefits on an ad hoc basis and as a tool to increase revenue in the short run, without fully considering the long-term implications of such legislation. Too often, such legislation has been formulated and finalized in "eleventh hour" sessions without adequate discussion or representation from plan sponsors, service providers and regulatory agencies. We must adopt a national policy statement on how we want private employee benefits to impact our lives and those of our children.

We believe it is imprtant that Congress, as it seeks to reduce the deficit, examine all tax incentives and federal spending program, not just those associated with employee benefits. Only after Congress has reviewed the cost, value, and the distribution of benefits among the population of all tax incentives and federal programs, is it possible to discuss any changes in the tax status of employee benefit arrangements.

GENERAL COMMENTS

A short time back as history counts time—no more than three-quarters of a century ago—the average working person could:

Become ill, forfeit his pay for the period of his illness, spend his meager savings in the process of recovering, and none but his family would care.

Become disabled, lose his earning power, sink with his family into poverty—and no one but his kin would be concerned.

Grow old without savings to support him, lose his place to younger, stronger workers and retire in penury.

Die early in life with nought for his surviving family.

Historians persist in calling this era of domestic concord and international amity "La Belle Epoque"—the beautiful time. Yet in the everyone-for-himself pursuit of industrial progress, the arrangements for dealing with the vicissitudes that might befall the average working person were individual, largely voluntary and very much uncertain. Henry Steele Commager summed up the social attitude of the day, as embodied in the stories schoolchildren read in their McGuffey Readers: "Have faith. Should ill befall you, some kind person will provide."

Today, thanks to both the persistence of Congress in building a system of social support and the forbearance of Congress in encouraging the private sector to join in this effort, working people no longer need to depend upon the magical appearance of "some kind soul" when ill befalls them. In the 73 years since the first employer bought for his employees the first group insurance policy, this country has developed a system of social support that is certain, manifold, unique and—as subsequent discussion will show—robust, adaptable and growing more extensive with each passing year.

Today the typical working person can look at the evils that might befall him and know that employer sponsored benefits will:

Pay health bills when he is ill;

Provide income during periods of both short and long-term disability;

Provide a solid foundation of life insurance benefits; and

Produce in retirement years an income proportional to his work life earnings.

As we will demonstrate, private enterprise has built an effective and efficient arrangement covering the needs of employees through employer-sponsored pension and welfare plans. It benefits the majority of rank and file workers and their dependents and is far superior to any government program which could replace it. It should not be modified in the name of greater tax revenues. Employee needs are there and must be met and if private enterprise is not encouraged to meet those needs, government will inevitably be pressured into doing the job. We believe the ultimate price to our nation would be greater.

To be sure, there are blemishes in the tapestry of employer-sponsored pension and welfare plans which will need attention in the years ahead. But, in recent years, Congress has placed too much emphasis on tax revenue in drafting legislation that affects pension and welfare plans. Congress needs first to study the security these programs deliver to America's workers—in every income bracket and in every state—and then try to develop a national policy before legislating further.

So, in this statement we want to focus attention on the part of the glass that is full, rather than on the part that is empty. These employer-sponsored programs are of major importance to the rank and file workers of America. The programs have a simple goal. Coupled with government programs, the objective of employer-sponsored programs is to replace wages lost through retirement, death or disability, and to protect against a significant portion of catastrophic medical costs.

How broadly has this goal been met? The response of the private sector has greatly reduced the need for government funded social programs. The health insurance programs of U.S. businesses today cover about 162 million persons under age 65 through some form of private group health protection. This private effort has very much reduced the demands on government for a national health insurance program and its accompanying need for increased taxes. The pension programs of the U.S. businesses are maturing: by the time individuals age 35-44 in 1979 retire, 71% can expect to receive a pension benefit. The growth in private pensions substantially reduces pressure on the Social Security system to increase benefits and, therefore, to increase Social Security taxes.

The Congress has been wise for decades in legislating, through the tax laws, encouragement to American business to create and maintain these programs for workers' security. As a result, the United States now has a partnership between government programs and employer-sponsored programs that delivers income security to most workers against the major hazards of life. In the years ahead, your task will be to legislate to maintain and improve this public/private partnership. The "tax expenditure" for employer-sponsored programs is large because these programs are and will be providing income security to most workers. Programs providing benefits across the spectrum of the work force do not come cheap.

Congress should continue to provide maximum encouragement, through the tax laws, for the vigorous growth and expansion of employer-sponsored pension and welfare programs. Also, any proposals to increase the Social Security wage base through the addition of non-taxable employee benefits should be rejected. Since the financial status of the Social Security system has just recently been strengthened, any effor to increase the wage base must be considered unnecessary and counter production is the goal of preserving and strengthening the structure of employer-sponsored programs.

As part of the effort to reach a national policy on employer-sponsored pension and welfare programs, we ask the Congress to think long and hard on one fundamental. The goal is to provide lifetime financial security for workers. To plan and carry out programs that run for decades, employers need *stability* in government policy and rules. Lately the Congress has been changing the rules for these programs in virtually every session. This creates an unstable environment full of uncertainty which forces employers to think almost entirely in the short range. To preserve and strengthen the structure of employer-sponsored programs, Congress should retreat from this counterproductive annual revision of rules for pension and welfare programs, and focus instead on the long view. We understand the forces that have pushed for an annual tinkering, but these must be resisted for the long-term welfare of American workers and their families.

EMPLOYEE PENSIONS

Social Security, employer-sponsored retirement plans and individual savings, together, have traditionally been used to provide retirement income security for American workers and their families. It is important that there be a proper balance among the three mechanisms. In this regard, the function of the Social Security system is to provide only a basis floor of income protection for retired and disabled workers and for the survivors of deceased workers.

There are two basic reasons why the private system for providing retirement benefits should be voluntary. First, it is consistent with the market orientation of our society. Even if the terms of a pension agreement are not bargaining in union negotiations, an employer has good reason to cast his pension plan in a form most valued by his own employees: plans are too expensive for an employer to provide unwanted benefits. Moreover, government has minimum flexibility when administering programs for everyone, but private decisions provide flexibility and minimize political problems. Through the private employer-sponsored pension system, workers and employers can easily adjust to changing views about retirement age and other retirement issues. The other basic reason is that retirement provided through Social Security does not generate a supply of capital as do private savings arrangements.

These two reasons—more individualized choice and more private capital—provide strong arguments for placing heavy reliance on the private pension system for retirement income protection. There is an additional consideration: the tax benefit given to pension plans only postpones the tax on savings. In the current academic debate about tax policy, there is a considerable school of experts who say the right way to tax all savings is to postpone tax until the income is consumed and that current taxation of savings results in double taxation.[1]

Future retirement benefits under employer retirement plans

Private pension plans currently make a substantial contribution to meeting retirement needs of American workers. In 1979, more than 74% of full-time, full-year workers participated in an employer pension plan.[2] Moreover, a significant percentage of all workers are employed by firms with pension plans so that non-participating workers have the potential to participate in plan and receive pension benefits.

Despite these impressive statistics, trends in pension coverage and participation have recently been the subject of criticism and the perception in Congress that pension coverage is not wide-spread. In our view, however, these discussions of pension coverage often miss several important points about the structure of employer retirement programs and their relation to retirement income. Two important questions which must be recognized are: (1) what percentage of families will receive private pension benefits upon retirement? and (2) what will be the size of the average pension benefit?

Since 1980 the Council commissioned ICF Inc., a Washington, D.C. consulting firm, to undertake two studies of these important questions. In October 1982, ACLI published a report on ICF's findings entitled, "Pension Coverage and Expected Retirement Benefits."

The study completed in 1982 concluded that the role of pensions could be expected to expand substantially in the future as the pension system matured. The study showed a dramatic increase over the 25-year period from 1979 to 2004 in the proportion of families age 65 to 69 drawing an employer sponsored pension.

This study was based on detailed information about the U.S. work force, collected by the Census Bureau, and a careful projection of how workers would gain or lose pension coverage as they aged. The evidence of the study was that in each year over the next 25, more retiring workers will have spent much of their working lives under the broad coverage and fast vesting pension rules in place after the enactment of ERISA. The increased proportion of retirees getting pension benefits does not involve any assumption of pension growth; only a projection of conditions actually revealed by the Census study in 1979. The study found that private pension and Social Security benefits alone could be expected to replace over 75 percent of after-tax pre-retirement income in the initial year of retirement for over one-half of all families.

In part because the results of the Council study challenged many preconceived notions about the role of employer pensions, the study's methodology and results were scrutinized carefully. For example, in late 1982, the House Select Committee on Aging asked the Congressional Research Service (CRS) to examine the study's results and its methodology. Their review culminated in a report prepared in July 1983 by the CRS for the House Committee on Aging. Other formal and informal critiques of the study were also prepared.

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[1] On this academic discussion, see "What Should be Taxed—Income Expenditure"? Jos. Pechman ed. Brookings, 1980.

[2] Schieber & George, "Retirement Income Opportunities in an Aging America: Coverage and Benefit Entitlement" (Washington, D.C., Employee Benefit Research Institute, 1981)

The CRS review was, on the whole, complimentary to the ICF study but, as did other reviewers, suggested that the results might change if various key assumptions were changed. To respond to the major questions which had been raised, ACLI contracted with ICF in 1983 to conduct additional research on expected retirement income receipt.

The major findings of the 1984 study have just been published and confirm the findings from the 1982 study that benefit receipt under private pension plans will increase sharply and that the average pension will increase faster than wages:

The percentage of families receiving pension benefits will increase rapidly in the future.—The percentage of families expected to receive employer pension benefits is increasing rapidly. The study shows that by the time those individuals age 35-44 in 1979 reach age 67, approximately 82 percent of all married couples and 58 percent of unmarried individuals can expect to be receiving employer pension benefits from at least one spouse's covered employment. Table 1 below shows that benefit receipt at age 67 for the group age 35-44 in 1979 will be 25 percent higher than benefit receipt for the group age 45-54 in 1979. Even these estimates understate the potential levels of benefit receipt because about 10-15 percent of individuals who will still be working at age 67 and are nonetheless eligible for pension benefits are not counted as receiving benefits.

Due primarily to the increase in the labor force participation rates of women and the maturing of the pension system, Table 1 also shows that married couples have a substantial likelihood that at least one family member will receive a pension benefit. In addition, unmarried individuals have a substantial likelihood that they will receive either pension benefits from their own prior employment, or survivor benefits from a former spouse's employment.

TABLE 1.—EXPECTED AVERAGE FAMILY PENSION BENEFITS AT AGE 67

[In 1983 dollars]

	Cohort age 45-54 in 1979		Cohort age 35-44 in 1979	
	Percent receiving benefits	Average pension benefits	Percent receiving benefits	Average pension benefits
Married couples	70	$8,200	82	$10,000
Unmarried individuals	44	5,500	58	7,400
All families	57	7,200	71	9,300

Source: ICF estimates. This table does not include benefits from IRA's. It understates the percentage of families eligible for pension receipt because individuals working at age 67 who have a vested right to a pension benefit are not counted as receiving benefits.

Pension benefit levels will also increase. Table 1 shows that the average family pension benefit at age 67 will increase to approximately $9,300 per year (in 1983 dollars) for those individuals age 35-44 in 1979. This is an increase of almost 30 percent as compared to the average family pension benefit at age 67 for those individuals age 45-54 in 1979. The built-in assumption of wage growth over time means that the age 35-44 group would have real wages 16 percent higher at retirement than the age 45-54 group. The remaining 14 points of the 30 percent increase reflect the continuing maturation of the pension system. Specifically, workers aged 35-44 in 1979 will have worked under expanded employer pension programs and under supplemental retirement plans and ERISA's vesting rules for 10 more years than workers aged 45-54 in 1979.

Pension benefit levels will be significant at all income levels. The study shows that among individuals age 35-44 in 1979, average pension benefits at age 67 will be slightly larger than average Social Security Benefits. Thus, the average annual pension for this group will be about $9,300 (in 1983 dollars) while Social Security will be only $8,700 (in 1983 dollars).

Pension and Social Security benefits combined will replace 70 percent of pre-retirement income. The study calculated the expected replacement rates for families which were not working in retirement. As expected, replacement rates from Social Security and employer pensions will be higher for low income workers. Social Security and pension benefits will replace an average of over 100 percent of pre-retirement income in the initial year of retirement for families who earned an average of less than $10,000 per year (in 1983 dollars) in their highest five years of income after age 65. Replacement rates fall below 60 percent for income groups above $20,000. The study also estimates that over 70 percent of those families with an average of less than $10,000 in pre-retirement earnings will receive retirement benefits that replace over 80 percent of their income. On the other hand, less than one-quarter of those with over $15,000 in pre-retirement income will have replacement rates larger than 80 percent.

Pension benefits will be widely distributed.—While a significant number of families can expect to receive income from private pension plans, the distribution of average pension benefits differs among family categories. For families with individuals age 35–44 in 1979, more than 60 percent of married couples and almost 40 percent of unmarried individuals can expect to receive annual pension benefits above $2,500 (in 1983 dollars). Over 35 percent of married couples and 18 percent of unmarried individuals can expect to receive annual pension benefits above $7,500 (in 1983 dollars).

Pension funds in U.S. capital markets

Retirement savings are an important source of long-term investment in the capital goods so essential for a growing and dynamic economy. The general importance of pension funds in capital markets is suggested by the data in Appendix 1. At the end of 1983, total assets of private pension plans and state and local retirement plans amounted to nearly $1 trillion. From 1980 to 1983, the total grew at about a 15 percent annual rate (which includes the effect of stock market and other capital gains).

Private pension plans and state and local retirement plans are providing a growing part of the funds supplied to U.S. credit and capital markets. In Appendix 2, flows of pension funds to U.S. credit and capital markets are shown by major type for recent years. In 1983, these pension funds supplied about $101 billion, or 19 percent of the total funds raised in U.S. credit and capital market. Five years earlier, 1978 these pension plans provided 12.5 percent of the total funds raised in these markets.

The assets of non-insured private plans generally are more concentrated in corporate equities and U.S. government securities than are the funds of "insured pension plans (Appendix 3). About one fourth of the pension funds administered by life insurance companies are now held in separate accounts. The assets in these accounts are largely in corporate bonds and corporate equities, but with a growing amount in mortgages and real estate (see Appendix 4). The remaining three fourths of these funds, handled through general accounts of life companies, are invested primarily in corporate bonds and commercial mortgages.

EMPLOYEE GROUP LIFE INSURANCE

The purpose served by group life insurance is to replace the income lost through the occurence of an employee's untimely death. By promising such replacement, group life insurance also serves to improve the morale and productivity of employees by relieving them of significant anxieties and risks resulting from death. Employer-sponsored benefit plans are the best way of accomplishing this purpose. Corporate-sponsored employee benefit plans are now an integral part of the attitudes and philosophy of our economic way of life.

The initiative for group life insurance has primarily come from corporate management, spurred on by insurance companies who recognized the need for employee protection and who formulated the instruments for serving that need. In slightly less than three-quarters of a century, the concept of protecting a wage earner against the physical hazards that threaten his or her paycheck has become an accepted part of private industry's thinking. The tremendous growth of group life insurance programs, not only in the number of workers insured, but also in the variety of coverage available, is a heartening illustration of what the private sector can accomplish in the way of economic security for the wage earner.

The quest for economic security will not diminish in intensity; rather it can be expected to increase. The solution lies in the hands of private enterprise. That is, small, as well as large employers, must be encouraged to continue to accept the social responsibility of adequately protecting their employees against the loss of income through untimely death or disability.

Since its beginning in 1911, employee group life insurance has enjoyed wide public support. In the editorial column of the Saturday Evening Post of October 4, 1913, appeared the following observation: "No married man who has not a fortune has any business to be without it (life insurance). We should like to see this group-risk plan elaborated until life insurance and paycheck go together". When the Union Pacific Railroad established its plan in 1917, one well-known religious figure was quoted, "The system is the practical putting into effect of the principles of Christian charity. It establishes the most friendly relations in the minds of all and brings about harmony and sympathy."

The attitude of the individual worker has also generally been favorable to group life insurance plans. The files of insurance companies are full of grateful acknowledgements from widows and widowers who had no finances other than group life insurance proceeds to help them over the difficult period of readjustment following the deaths of their spouses. By opening the channels of insurance to all industrial workers, regardless of age, sex, physical condition, or character of employment, group life insurance has performed an outstanding service.

The growth of group life insurance has been prodigious since its introduction in 1911. At the end of 1983, group life insurance in force through employers was $1.7 trillion and more than one-half million employers of all sizes had purchased life insurance for their employees. In a 1983 survey conducted among medium and large employers by the U.S. Department of Labor, 95 percent of all employees were reported to be covered by group life insurance. And, while the numbers are not quite as dramatic, a 1983 survey conducted by the Life Insurance Marketing and Research Association (LIMRA) among employers of 3–50 employees indicated that more than 80% had purchased a group life insurance policy as part of a package of employee benefits. Group life insurance is a near-universal employee benefit in the United States.

The amounts of life insurance provided through employer-sponsored plans is typically related to the individual employee's salary. According to a recent survey conducted by Hewitt Associates among major U.S. employers, in 1983 approximately 73 percent of all such employers had purchased group life insurance schedules that were salary-related, with the most popular salary multiples being 1-times (32% of the employers) and 2-times (22% of the employers). In a survey conducted by the Council in April, 1981, more than 50 percent of the total claim payments made under group life insurance policies were in amounts exceeding $25,000 per beneficiary.

Employer-provided group life insurance also reflects the changing nature of the American work force. It is well-known that increasing percentages of women are entering employment. According to a recent Council publication, nearly 52 percent of all married women were in the workforce in 1982, up from 41 percent in 1971. A Council study of trends in death benefit payments under group life insurance policies indicated that in April, 1981 almost 20 percent of the deaths were female employees, representing a significant increase over the 13 percent reported in October, 1966.

In recent years, the attractiveness of group life insurance has led an increasing number of employers to extend such insurance beyond the working years of their employees. In a survey conducted by The Conference Board in 1979, more than two-thirds of a sample of large and small employers indicated that they were continuing some group life insurance protection into retirement. A later survey conducted in 1983 by Hewitt Associates indicated that among large employers the percentage exceeded 80 percent.

And, as a growing number of states change their restrictive group insurance laws, employers are extending their group life insurance plans to include spouses and dependent children. Where now permitted, the aforementioned Conference Board survey indicated that 25 percent of large and small employers were providing some dependent group life insurance.

As shown by these statistics, employer-provided group life insurance has grown rapidly in the 73 years since it first became available. There are broad social aspects to the growth of group life insurance. One great service of group insurance is that it extends life insurance coverage to a large number of persons with little or no other life insurance. And, group life insurance also extends protection to persons who cannot qualify for individual life insurance either because of physical problems or hazardous occupations. The proportion of employed persons who are uninsurable for individual policies has been variously estimated between 5 and 10 percent. It is only through group underwriting that private life insurance can provide protection for these persons, and it is advantageous both to the individual and to society that insurance be made available to them.

EMPLOYEE GROUP HEALTH INSURANCE

Group health insurance is of enormous value to the public and our industry has been highly successful in meeting the needs of American workers. Federal tax incentives played a major role in that achievement. They continue to be essential element in the present system for the protection of employees and their families.

The health insurance provided under employee benefit plans falls into two broad categories. The first is represented by benefits for hospital, physician, dental and other medical expenses. A great variety of coverages is available from many companies active in the market, in response to strong consumer demand. We estimate that at the end of 1982, almost 65 million workers had group health coverage. Including spouses and children, approximately 162 million persons under age 65 were covered by one or more forms of private group health protection, either through our member companies or through other arrangements. That represents 80% of the under 65 civilian non-institutionalized population, and is a five fold increase since the end of World War II. Although more remains to be done in expanding the number covered, we are proud that much has been accomplished.

The second category of health insurance represents income payments to disabled workers for either short or long-term benefit periods. In 1982, almost 62 million workers had short-term protection under various private arrangements, of whom 27 million were covered under insurance company group plans. Most commonly, employees' short-term coverage lasts 26 weeks and income benefits usually equal two-thirds of salary. Many employees are covered for long-term disability, with benefit periods of five years or to age 65. At the end of 1982, 17 million persons were covered under group plans for long-term disability. Carriers have continuously explored every opportunity to further extend disability income coverage to employees, and to ensure that adequate benefit levels and payment durations are available.

The questions posed related to tax incentives to employers to encourage health benefits for their employees. The tax incentive to the employer is the deduction allowed for the cost of the benefits. The employer cost is not taxable income to employees, although disabled employees are subject to tax on income benefits in whole or in part. Thoughtful issues have been raised, which should lead to a productive discussion of the subject.

In our view, tax incentives can be justified if desirable public objectives are achieved through the appropriate response of private enterprise. For many years there have been tax incentives to encourage employers to provide health benefits to employees. We believe that a major public objective has been achieved in that 162 million persons—workers and their families—have one or more forms of group health insurance protection. Secondly, that achievement has been accomplished by private enterprise, which, through competition in a free economy, has delivered its product to the best advantage of the consumer. We believe the wisdom of granting the tax incentives has been well proven for the following reasons.

The protection of the public.—Over the past several years, most Americans have come to recognize that medical expense insurance is a basic necessity. Today it is indeed reckless to risk financial devastation on account of accident or sickness. Adequate group health coverage eliminates a major source of fear and uncertainty for those who are covered, both rich and poor alike. Group medical expense benefits are the same for both high and low income employees, and provide access to health care services that might otherwise be unaffordable. The existence of Medicare and Medicaid demonstrates government's commitment to coverage for those for whom public programs are necessary. It is the private sector that has met that same need for the bulk of the population through employee health benefit plans.

The ability of private companies to offer group insurance goes hand in hand with the tax incentives for employers and employees. The relationship can be explained by a brief description of how group insurance is underwritten.

Under current industry practice, medical expense and disability income benefits can be made effective for an employee group without individual medical evidence of insurability, if at least ten employees are involved. The usual rules only require that the employees enroll when first eligible, and that they be actively at work when coverage is to become effective. Dependents are also covered on a non-medical basis under similar rules. This liberal approach to offering coverage is of enormous importance to the public, since many persons become group insured who would have difficulty obtaining medically underwritten individual insurance.

Insurance companies can appropriately price group health insurance and maintain acceptable financial experience, despite the absence of individual evidence of insurability. The reason is that a high degree of employee participation in the plan is required. If the plan is contributory, at least 75% of employees must enroll, and all employees must be covered under non-contributory plans. With these participation requirements, a reasonable cross section of risks is obtained which provides stability ot the financial experience. These rules ensure that both young and old employees enroll, and also the healthy as well as those who have medical problems.

There is usually no difficulty in getting employees to enroll, since the value of health coverage is appreciated and the employer pays all or nearly all of the cost of the plan. Furthermore, the employer contribution is not taxable income to the employee. There is a supportive relationship between tax incentives which encourage employers and employees to participate in group health benefit plans, and the ability of insurers to successfully underwrite such coverage without medical evidence of insurability. This has worked so well that the protection of 162 million Americans under 65 has been accomplished by the private sector without any need for federal intervention.

Response of the private sector.—As noted above, a justifiable tax incentive policy should accomplish desirable public objectives through the appropriate involvement of private enterprise. The protection of the working public through employee health benefits has been accomplished by private enterprise in a very effective manner. We believe that our industry has developed group health insurance in the best traditions of a free economy, further confirming that tax incentive policy was the right approach for government. Today, the group insurance market place is served by hundreds of insurers, offering extensive portfolios of health benefit plans to fit a variety of circumstances and employer pocketbooks.

It was insurance company innovation that brought high limit major medical expense coverage to the market. That form of insurance, introduced nationally in 1951, covers a wide range of medical services provided both within and outside the hospital, and was designed to encourage use of out-of-hospital services. It is by far the most prevalent form of medical insurance today, with over 90% of those protected by group plans having major medical coverage. A 1980 study showed that for employees with major medical protection provided by insurance companies, about three-fourths had a maximum benefit of $250,000 or more. Nearly half had a maximum benefit of $1 million or an unlimited amount. Insurance company innovation also brought to the market dental expense and vision care insurance, as well as benefits designed specifically to contain the acceleration in health care costs. Illustrations of such benefits include coverage for skilled nursing facilities, home health care services, pre-admission testing, second opinions for surgery, ambulatory surgery facilities, preventive care, hispice care and drug and alcohol rehabilitation.

The pluralistic nature of the private health insurance business has resulted in intense competition among carriers. As a result, an insurer must keep its premiums as low as possible which provides both employees and employers with the most cost effective protection possible. The consumer interest is also protected through our system of state insurance regulation, covering such areas as group policy and certificate provisions, group conversions, and so forth. In fact, due to the flexible nature of the business, employees may continue to maintain medical expense protection upon termination of employment by either converting to an individual policy or continuing benefits under the group plan for various periods. In many instances, coverage is also continued for a specified time for dependents who lose eligibility due to an employee's death or divorce.

A particularly relevant example of how the competitive insurance market place served the public interest was the development of group insurance for small employers with as few as one or two employees. According to Department of Commerce data, there were 4.3 million firms with one to forty-nine employees in 1980. These small groups probably provide employment for over 15 million workers. To serve that market, insurers developed pooling techniques and simplified underwriting rules and, as a result, small employers today have a wide choice of plans. The stimulus of tax incentives and the willingness of carriers to voluntarily enter the small group market have been of great benefit to small employers and their employees and families. As a result, small firms can today obtain many coverages once only available to large groups, and can fully realize the advantages of the tax incentives in the law.

Overall, the encouragement of health insurance coverage through tax incentives has been enormously successful in terms of social and economic accomplishments. The present system of employment related health benefits was built up over several decades, and works very well. Americans have come to regard employer-sponsored health protection almost as an automatic feature of employment, providing benefits of great value. In our view, no change should be made in tax incentives which might impair the ability of the private sector to provide essential insurance protection to the public.

The Subcommittees have asked whether the existing tax incentives are effective in protecting the working public at a lower total cost than alternative mechanisms or arrangements. The implication is that under such alternatives, there would either be cutbacks in or the elimination of the present tax incentives.

Let us consider one alternative based upon the supposition that all employer contributions to health benefit plans would be taxable income to employees, either immediately or on a phase-in basis. Our industry stands on record in firm opposition to such taxes because of the many flaws in that approach. At this time however, we shall confine our discussion to how such a change could affect the ability of insurers to offer insurance products and the likely cost to consumers.

A fair allocation of employer contributions to each employee for tax purposes would be a very complex task. Whatever formula was used, the total cost of group health insurance would be increased by the amount of tax raised. The cost to a particular employee to participate in the group plan would become the employee's contribution plus his tax on the allocated employer contribution. For many employees, the cost to participate would increase sharply, causing both the discontinuance of coverage and the weakening of the group insurance mechanism through adverse selection. This may be seen as follows:

In the first instance, low income employees, especially those that live in our major urban areas, would be particularly hard hit by the tax. In our highest cost cities, annual premiums for small group family coverage can be $4,000 to $5,000 in the middle age ranges, and higher at older ages. While imputed income would be the same for high and low income employees, the tax impact on the low wage earner would be much more severe in terms of affordability. It is likely that low income employees without health problems would be pressed to drop their group health coverage. That could mean disastrous consequences for such families upon subsequent illness, and government might have to eventually shoulder an increased burden under public programs.

There are other employees that might decide to withdraw from group coverage in addition to low income workers. Examples are young healthy employees that can secure individual coverage at a lower cost than the group employee contribution plus income tax. When employees have incentives to either go without group insurance, or purchase individual coverage, the group plan is exposed to adverse selection through low participation. A good cross section of health risks is more difficult to maintain. As a result, the average health status of the insured group is poorer and premiums must rise, which causes more employees to drop out. The resulting spiral of higher premiums and increased withdrawals can threaten the financial viability of group plans, especially in the small group range.

The opening of the door to adverse selection could seriously undermine the group insurance mechanism through which millions have been protected on a non-medical basis. Overall, the removal of the present tax-free status of employer contributions could easily result in a drop in the number of people protected, especially low income employees in high costs cities. Furthermore, more adverse selection would occur, impairing the financial stability of many group plans and the ability of carriers to underwrite liberally. That indeed would be a heavy price to pay for any additional tax revenues raised.

Such deterioration of the present system would certainly result in renewed political pressure for national health insurance. We estimate that in 1983 the cost of private group medical expense coverage was in the range of $105 to $110 billion, with financing and benefits determined by market place conditions, involving carriers, employers, and unions. With a government operated plan, Congress would face the difficult task of raising new taxes each year equal to or greatly in excess of these amounts. In view of the financing problems now posed by Medicare, Congress would be ill advised to embark upon such a vast public program.

In our view, any alternative to the present system must be subjected to searching analysis to determine just what improvements are possible. We know what the private sector has been able to accomplish with the stimulus of tax incentives. We are deeply skeptical that major changes can be made to generate new revenue without weakening the present employer health benefits structure that has worked so well.

CONCLUSION

As this statement has shown, the private sector has accomplished a great deal in providing socially valuable benefits to American workers and their families. The job, however, is not done—there are still gaps in coverage. The private sector is anxious to close these gaps, but it needs help. Tax incentives have worked in the past, but they must be continued and, where appropriate, expanded, to provide the impetus necessary to complete the job.

APPENDIX 1.—PENSION PLAN RESERVES IN THE UNITED STATES

[Amounts in billions]

	Total	Pension reserves of life insurance companies	
		Amount	Percent of total
1970	$211.9	$41.2	19.4
1975	323.8	71.7	22.1
1980	650.7	165.8	25.5
1983	993.6	264.6	26.6
Average annual compound rate (percent) of increase:			
1970–80	11.9	14.9	
1980–83	15.2	16.9	

[1] Includes reserves and assets of pension plans administered by life insurance companies, other private pension plans, and state and local government retirement plans.

Source: Board of Governors of the Federal Reserve System, Flow of Funds Accounts, and American Council of Life Insurance.

APPENDIX 2.—PRIVATE PENSION PLANS AS A SOURCE OF FUNDS IN U.S. CREDIT AND CAPITAL MARKETS

[Amount in billions]

Year	Total funds supplied	Funds supplied by					
		Pension plans with life insurance companies		Other private pension plans		State and local government retirement plans	
		Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
1978	$390.2	$18.3	4.7	$16.0	4.1	$14.3	3.7
1979	400.1	17.5	4.4	16.0	4.0	19.4	4.8
1980	374.1	20.6	5.5	20.3	5.4	23.4	6.3
1981	377.6	28.6	7.6	21.1	5.6	24.3	6.4
1982	397.0	32.7	8.2	26.5	6.7	26.8	6.8
1983 [1]	527.2	37.9	7.2	31.7	6.0	31.5	6.0

[1] Preliminary.

Source: Bankers Trust Company, "Credit and Capital Markets 1984", and Board of Governors of the Federal Reserve System, "Flow of Funds Accounts."

APPENDIX 3.—USES OF FUNDS BY PRIVATE NONINSURED PENSION FUNDS

[In billions]

	1978	1980	1982	1983 [1]
Corporate bonds	$7.4	$3.1	$3.5	$3.6
U.S. Government and agency securities	−.1	4.5	10.2	8.4
Corporate stocks	5.3	9.6	11.5	18.0
Mortgages	2.5	1.8	1.3	1.5
Other	.9	1.3	....	2.0
Total	16.0	20.3	26.5	31.7

[1] Estimated.

Source: Bankers Trust Company, "Credit and Capital Markets 1984."

APPENDIX 4.—DISTRIBUTION OF ASSETS HELD IN SEPARATE ACCOUNTS OF LIFE INSURANCE COMPANIES [1]

[In millions]

	1970	1975	1980	1982	1983
Bonds	$878	$2,553	$12,392	$24,563	$27,294
Stocks	4,041	9,323	17,705	20,641	25,118
Mortgages	37	200	687	2,556	4,372
Real estate	2	563	3,341	5,686	6,437
Other	103	334	1,647	3,835	4,635
Total	5,061	12,973	35,772	57,281	67,856
Memo: Total pension reserves of life insurance companies (billions)	41.2	71.7	165.8	225.2	264.6

[1] Assets in separate accounts are valued at market or, in the case of real estate, appraised market value.

Source: American Council of Life Insurance.

STATEMENT OF DR. EMILY S. ANDREWS,[*] WASHINGTON, DC

SUMMARY

This testimony presents new information on the distribution and the economics of employer-provided pensions to help in the evaluation of the current system of fringe benefits. Two basic issues are investigated which focus on the fairness and economic efficiency of pensions, the keystone of our employee benefits system:

(1) Are employer-provided pensions distributed fairly across the workforce? and;

(2) Have the cyclical costs of the 1982 recession reduced the likelihood of future retirement income for today's employees?

The data supporting the analysis stem from a new nationwide survey sponsored by the Employee Benefit Research Institute (EBRI), in conjunction with the Department of Health and Human Services, conducted by the U.S. Bureau of the Census in 1983. The survey represents, in part, a follow-up to a similar effort conducted in May 1979 funded by the Department of Labor and the Social Security Administration. The EBRI/HHS survey parallels the May 1979 effort but adds new information on lump-sum benefits, individual retirement accounts (IRAs) and section 401(k) salary reduction programs.

Analysis of the distribution of coverage and vesting by earnings category indicates that pensions are broadly distributed among lower- and middle-income workers. In particular, 76 percent of all nonagricultural wage and salary earners covered by a pension earn $25,000 a year or less. Similarly, 70 percent of all vested benefits belong to nonagricultural employees earnings $25,000 or less.

May 1983 EBRI/HHS survey data also show that women are gaining pension entitlement in greater numbers than ever before. Among those women meeting ERISA standards for plan participation, coverage expanded by 2.2 million workers since 1979 and nearly 1.3 million more women became entitled to pension benefits at retirement.

The 1983 EBRI/HHS survey also provides the first information on entitlement to lump-sum benefit receipt. The addition of lump-sum benefits increases the total vesting rate by over 10 percentage points for private-sector employees and by nearly 20 percentage points for public-sector workers. Total vested benefits increase gradually with age providing greater protection as workers near retirement age. A comparison of total vested benefits with utilization rates from IRA and 401(k) plans indicates that coverage provided by employer plans is broader than that selected by individuals themselves.

Changes in coverage and pension entitlement between the May 1979 and May 1983 surveys are also investigated in order to determine the cyclical costs of the recession on the pension system. At the time of the survey the unemployment rate was at 10.1 percent, just six months after the business cycle trough. Nevertheless,

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employment growth since 1979 among those workers meeting ERISA standards led to an increase of over one million workers covered by a pension plan or a total of 38 million employees. (Coverage among all nonagricultural wage and salary workers totaled 49.5 million.)

Furthermore, employer pensions have not undergone a financial crisis comparable to that suffered by Social Security. The pay-as-you-go Social Security system was buffeted by the results of sluggish economic growth in which prices rose faster than wages. As a consequence, indexed benefits exceeded contributions culminating during a period of double digit unemployment. Funded plans are designed to withstand cyclical uncertainties, however. In sum, while the employer-provided pension system bore certain recessionary costs, its structural underpinnings remained sound.

STATEMENT

Introduction

Employer pension plans are frequently regarded as the cornerstone of our employer benefit system. Consequently, any assessment of the effectiveness of employer benefits must consider the success of pension plans in meeting future retirement income needs. The nation appears to be approaching a crossroads in pension policy. While tax incentives for the development of a fair employer pension system have been a consistent public policy landmark, the current budget deficit has placed pensions on the firing line. Even before our ballooning deficit, some were predicting a diminution of policy support for retirement. In 1980 William Graebner stated in *A History of Retirement:*

"A century after retirement became an important instrument of social and economic policy, we are preparing for its disappearance, again in a context established by the needs of captial and with the acquiescence of most Americans. We expected too much from retirement. We believed retirement would rejuvenate and stabilize the teaching profession, the churches, and the factories; spare us the distress of an aging bureaucracy; allow the payment of lower salaries; distribute work in declining industries and in an economy that, in many, sometimes lengthy periods over the last century, has failed to employ all who wanted to work. In our current difficulties, we assume that by reversing the process and dismantling the edifice of retirement, we can reinvigorate an economy that has lost its fine compentive edge. This is the mirror-image of the historic assumption that retirement is a powerful and inexpensive instrument of social reconstruction. A new myth replaces the old."

With today's information technology we need not conduct public policy through the perpetration of myths. Instead, researchers and legislators can consider facts carefully before proposing legislative changes. The hearings scheduled by the House Committee on Ways and Means on the Distribution and Economics of Employer Provided Frings Benefits happily reflect the Committee's desire to gather information to better inform Congress and the public. Work-in-progress at the Employee Benefit Research Institute Institute (EBRI) provides insights into some of the issues of interest to the subcommittees' on the distribution of employer provided benefits. This testimony presents new findings on the fairness and efficiency of the pension system using data from an EBRI-sponsored survey on pension coverage and entitlement, funded in conjunciton with the Department of Health and Human Services (HHS).

The survey, conducted by the Bureau of the Census in May 1983, represents a follow-up to an earlier May 1979 effort funded by the Department of Labor (DOL) and the Social Security Administration (SSA). The May 1983 survey goes beyond the scope of the previous study, however, by asking additional questions about lump-sum, distributions, individual retirement accounts (IRAs) and deferred compensation plans under section 401(k).[1]

In particular, data from the May 1983 EBRI/HHS CPS pension supplement are used to address two policy issues of interest to the Committee on the equity and economic costs of the system:

(1) Are employer-provided pensions distributed fairly across the workforce? and;

(2) Have the cyclical costs of the 1982 recession reduced the likelihood of future retirement income for today's employees?

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[1] Both the 1979 and the 1983 surveys were supplements to the ongoing Current Population Survey (CPS) which is conducted monthly by the Bureau of the Census to collect national statistics on employment and unemployment. Consequently, in addition to information on pension coverage and entitlement, the survey provides valuable data on labor force status, demographics and income.

In terms of equity, the following topics are pursued. What income groups benefit from empolyer pensions? Do patterns of benefit entitlement ensure that workers will be entitled to pension benefits when they reach retirement age? Do men and women partake equally in the pension system?

Analysis of the EBRI/HHS pension supplement data provides insights into the fairness of the pension system neglected in earlier studies. In addition, earlier findings on coverage and benefit equity are reevaluated and the extent of vesting is recalculated using new information on IRA participation, 401(k) coverage and lump sum benefits from the updated survey. Pension benefits are found to be broadly based and can be expected to provide an important source of income support for millions of future retirees.

Because the May 1983 EBRI/HHS CPS pension supplement was conducted just after the 1982 recessionary trough, the effect of the worst cyclical downturn in four decades can be analyzed. The cyclical behavior of coverage measures the cost of the downturn for pension protection. While the recession adversely affected plan growth, pensions still covered a majority of the labor force and the number of vested workers expanded. Private sector coverage rates fell less strongly than public sector rates suggesting that during the downturn the costs of coverage slippage were less severe for private sector employees.

Furthermore, employer pensions have not undergone a financial crisis comparable to that suffered by Social Security. The pay-as-you-go Social Security system was buffeted by the results of sluggish economic growth in which prices rose faster than wages. As a consequence, indexed benefits exceeded contributions culminating during a period of double digit unemployment. Funded plans are designed to withstand cyclical uncertainties, however. In sum, although the pension system bore certain recessionary costs, its structural underpinnings remained sound.

Who benefits from employer pensions

The fairness of the pension system can be analyzed according to information on the distribution of coverage and vesting by earnings, age and sex through a series of three core questions from the 1983 EBRI/HHHS pension supplement on pension coverage and entitlement. These remained virtually unchanged from the May 1979 DOL/SSA survey to ensure comparability. The core questions both pension surveys (and others of this type) ask about pension coverage, participation and future benefit entitlement.[2]

Although these questions appear straightforward, many survey respondents appear to have difficulty interpreting them and provide inappropriate answers from time to time. This problem has been recognized by other analysts of pension coverage and entitlement and is probably a result of the complex nature of the pension system itself.

In terms of coverage and participation, some employees appear to interpret the coverage question as their own inclusion in their employers' plan while others deny participation for no apparent reason. Consequently, the key coverage and participation responses appear to bracket the "true" number of plan participants. Given a choice between these two measures coverage was selected as the key indicator of the number of employees who may become eligible for future retirement benefits. It provides a relative overestimate of participation rates and an offsetting underestimate of vesting rates. Only findings on coverage and future benefit receipt are reported in this Testimony.

Much of the analysis focuses on two groups in the labor force—paralleling previous EBRI work on this topic.[3] The first group consists of all nonagricultural wage and salary workers. The noncorporate self employed are excluded as they can provide their own coverage through Keogh plans. Farm workers tend to be a temporary low-wage work force whom many believe are better covered through federal programs such as Social Security and Supplemental Security Income (SSI).

The second group consists of those workers with sufficient labor force attachment to accrue meaningful retirement benefits if covered by an employer pension plan. This group is referred to as the ERISA work force and is composed of employees meeting ERISA participation standards in 1983. These workers are between twenty-five and sixty-four years of age who work at least 1,000 hours annually and have been with their employer for one year or more.

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[2] In the case of the 1983 survey, the questions are (1) Does your employer contribute to a pension or retirement plan . . .? (2) Are you included in the employer or union sponsored plan? and (3) . . . Could you receive some benefits at retirement?

[3] See Sylvester J. Schieber and Patricia M. George, *Retirement Income Opportunities in an Aging America: Coverage and Benefit Entitlement,* (Washington, DC: Employee Benefit Research Institute, 1981).

A middle income benefit

Table 1 provides information on the distribution of benefit entitlement from three perspectives. The top panel shows the absolute number of nonagricultural workers employed, covered or vested in a public or private pension plan. Of the 88.2 million nonagricultural wage and salary workers, 49.5 million were covered by a pension plan and 28.7 million had accrued vested benefits. Both statistics far exceed the 13.7 million employees who earn over $25,000. The majority of employees who have a pension plan never see an expense account or a golden parachute.

TABLE 1.—EMPLOYMENT, COVERAGE AND VESTING: DISTRIBUTION BY EARNINGS FOR NONAGRICULTURAL WAGE AND SALARY WORKERS, MAY 1983

Earnings	Number of workers (thousands)		
	Employment	Coverage	Total vested benefits
Total	88,214	49,530	28,703
$1 to $4,999	10,014	2,433	358
$5,000 to $9,999	15,323	5,747	2,023
$10,000 to $14,999	17,827	10,328	5,484
$15,000 to $19,999	13,101	9,422	5,874
$20,000 to $24,999	10,283	8,159	5,641
$25,000 to $29,999	5,515	4,365	3,048
$30,000 to $49,999	6,611	5,547	4,072
$50,000 and over	1,615	1,371	1,106
Not reported	7,924	2,158	1,105
	Percentage distribution within earnings group		
	Employment	Covered to employed	Vested to employed
Total	100.00	56.15	32.52
$1 to $4,999	100.00	24.29	3.57
$5,000 to $9,999	100.00	37.51	13.20
$10,000 to $14,999	100.00	57.93	30.76
$15,000 to $19,999	100.00	71.92	44.83
$20,000 to $24,999	100.00	79.34	54.85
$25,000 to $29,999	100.00	79.14	55.26
$30,000 to $49,999	100.00	83.91	61.57
$50,000 and over	100.00	84.90	68.50
Not reported	100.00	27.23	13.94
	Percentage distribution across earnings groups [1]		
	Employment	Of coverage	Of total vesting
Total	100.00	100.00	100.00
$1 to $4,999	12.47	5.14	1.30
$5,000 to $9,999	19.08	12.13	7.33
$10,000 to $14,999	22.20	21.80	19.87
$15,000 to $19,999	16.32	19.89	21.28
$20,000 to $24,999	12.81	17.22	20.43
$25,000 to $29,999	6.87	9.21	11.04
$30,000 to $49,999	8.23	11.71	14.75
$50,000 and over	2.01	2.89	4.01

[1] Percentages exclude 9.0% of employees whose earnings are not reported.

Source: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement.

The tabulations in the second panel of table 1 have traditionally been used to analyze pension coverage. They show that coverage and vesting rates generally rise with higher earnings. The ratio of covered workers to employment rapidly increases from less than one out of four workers earning under $5,000 a year to nearly two out of five earning between $20,000 and $24,000 a year. Coverage rate increases tend to moderate by the $20,000 level.

The third panel of table 1 shows the distribution of employment, pension coverage and vesting across income groups: in other words, the ratio of all workers within a particular income bracket who are employed, covered or vested in a pension plan to the total number of employed, covered or vested workers. These statistics clearly show the prevalence of pensions among middle-income workers. More than half the work force, 51 percent of all nonagricultural employees, earns between $10,000 and $25,000 per year. A greater proportion of penson coverage is directed towards these middle-income workers, however. Covered workers within those income categories constitute nearly 59 percent of pension coverage. Furthermore, almost 62 percent of all vested workers fall within the $10,000 to $25,000 per year range.

Another way to examine the distribution of pension benefits is through statistics on the cumulative distribution of employment, coverage, and vesting by earnings. The data in table 2 are presented in this manner. In this case, the proportion of employment, coverage, or vesting held by employees earning less than a specific amount is calculated. Nearly 83 percent of all nonagricultural wage and salary workers earn less than the $25,000 cut off. Pension coverage and vesting roughly parallel the income distribution with 76 percent of covered workers and 70 percent of those holding vested benefits earning less than $25,000 as well. These roughly equivalent distributions are found despite the fact that many workers earning less than $5,000 a year do not meet ERISA participation standards.

TABLE 2.—CUMULATIVE DISTRIBUTION OF EMPLOYMENT, COVERAGE AND VESTING BY EARNINGS [1] FOR NONAGRICULTURAL WAGE AND SALARY WORKERS AND THE ERISA WORK FORCE, MAY 1983

[Employees in thousands, distribution in percent]

Earnings	Employment distribution	Coverage distribution	Vesting distributions	
			Total vesting	Benefit entitlement
Nonagricultural wage and salary workers:				
Total employees	88,214	49,530	28,708	22,217
Less than $5,000	12.47	5.14	1.30	1.26
Less than $10,000	31.55	17.27	8.63	7.78
Less than $15,000	53.75	39.07	28.50	26.30
Less than $20,000	70.07	58.96	49.78	47.13
Less than $25,000	82.88	76.18	70.21	68.12
Less than $30,000	89.75	85.39	81.25	79.77
Less than $50,000	97.98	97.10	96.00	95.51
Total earnings	100.00	100.00	100.00	100.00
ERISA work force:				
Total employees	54,363	38,058	25,480	20,027
Less than $5,000	2.50	1.05	0.61	0.54
Less than $10,000	16.21	9.67	6.54	5.98
Less than $15,000	39.46	30.70	25.45	23.82
Less than $20,000	59.54	52.39	46.98	44.85
Less than $25,000	76.48	71.98	68.40	66.67
Less than $30,000	85.89	82.86	80.08	78.85
Less than $50,000	97.13	96.48	95.71	95.23
Total earnings	100.00	100.00	100.00	100.00

[1] Percentages exclude 9 percent of nonagricultural wage and salary workers and 4.1 percent of the ERISA work force whose earnings are not reported.

Source: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement.

The May 1983 EBRI/HHS CPS pension supplement expanded the definition of vesting to include workers expecting lump sum distributions as well as those anticipating future pension benefits. The proportion of vested workers earning less than $25,000 a year is raised two percentage points, to 70 percent, above the rate posted when only future pension receipt is considered. In fact, 77 percent of those expecting only lump sum distributions earn less than $25,000.

IRA's and earnings.—The cumulative distribution of vested benefits by earnings under employer pension plans can be compared to the cumulative distribution of IRA participation using tables 2 and 3. Table 3 shows that 61 percent of nonagricultural employees using IRAs earn less than $25,000 per year in comparison to 70 percent of those vested in a pension plan. Spousal IRAs are less well distributed toward middle-income workers with only 40 percent of spousal IRAs held by those earning less than $25,000. Those eligible to contribute to a spousal IRA are more likely to be found in the upper income brackets. Only 47 percent of those contributing to an IRA with a nonworking spouse earn less than $25,000 a year. (The eligible population represents about 20 percent of all IRA participants.)

TABLE 3.—CUMULATIVE DISTRIBUTION OF IRA AND SPOUSAL IRA PARTICIPATION BY EARNINGS [1] FOR NONAGRICULTURAL WAGE AND SALARY WORKERS AND THE ERISA WORK FORCE, MAY 1983

[Employees in thousands, distribution in percent]

Earnings	Employment distribution	IRA distribution	Distribution among those eligible for spousal IRA	
			Contributes to IRA	Established spousal IRA
Nonagricultural wage and salary workers:				
Total employees	88,214	14,972	2,988	1,718
Less than $5,000	12.47	5.08	2.91	([2])
Less than $10,000	31.55	14.45	7.98	5.39
Less than $15,000	53.75	28.91	17.47	11.30
Less than $20,000	70.07	45.98	31.93	25.57
Less than $25,000	82.88	61.47	47.48	40.36
Less than $30,000	89.75	73.40	60.35	51.58
Less than $50,000	97.98	92.76	84.87	79.98
Total earnings	100.00	100.00	100.00	100.00
ERISA work force:				
Total employees	54,363	11,900	2,373	1,413
Less than $5,000	2.50	1.11	0.88	1.30
Less than $10,000	16.21	8.86	4.17	3.09
Less than $15,000	39.46	23.52	13.76	9.39
Less than $20,000	59.54	41.07	28.63	21.99
Less than $25,000	76.48	57.58	43.61	38.34
Less than $30,000	85.89	70.96	57.81	50.31
Less than $50,000	97.13	91.87	83.65	79.05
Total earnings	100.00	100.00	100.00	100.00

[1] Percentages exclude 9.9 percent of nonagricultural wage and salary workers and 4.1 percent of the ERISA workforce whose earnings are not reported.

[2] Number of workers too small for reliable rates to be calculated.

Source: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement.

Employer provided pensions are concentrated toward the lower three-quarters of the income distribution and provide more broad-based coverage than the coverage employees provide themselves through individual retirement accounts.

Women are gaining

Table 4 provides comparative statistics on coverage and vesting for men and women. Women made considerable employment gains between 1979 and 1983 growing by 3.3 million nonagricultural wage and salary earners. Women's employment gains were translated into improvements in coverage and vesting. The number of female wage and salary earners covered by a pension plan increased by 660,000 workers, while the number of women entitled to future retirement benefits jumped by 1.2 million.

TABLE 4.—THE STATUS OF COVERAGE AND VESTING AMONG WOMEN AND MEN, MAY 1979 AND MAY 1983

	Women (thousands)		Men (thousands)		Percent female)	
	1979	1983	1979	1983	1979	1983
Nonagricultural wage and salary workers:						
Employment	36,704	40,015	48,477	48,199	43.1	45.4
Covered workers	20,355	21,015	31,664	28,515	39.1	42.4
Total vested workers	(1)	10,884	(1)	17,824	(1)	37.9
Workers entitled to future benefit	6,790	8,018	14,609	14,199	31.7	36.1
ERISA work force:						
Employment	18,847	22,970	30,888	31,393	37.9	42.3
Covered workers	12,972	15,207	23,918	22,851	35.2	40.0
Total vested workers	(1)	9,427	(1)	16,053	(1)	37.0
Workers entitled to future benefit	5,778	7,065	13,164	12,962	30.5	35.3

[1] Data not available for 1979.

Source: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement and May 1979 DOL/SSA CPS pension supplement.

By contrast, male employment edged down by 278,000 employees in the face of the most severe recession since World War II. Pension protection for men slipped through layoffs, dismissals and plant closings in many of the high coverage manufacturing industries.[4] As a result, the proportion of women among covered wage and salary workers increased from 39.1 percent to 42.4 percent. Similarly, the proportion of future pension benefits claimed by women jumped from 31.7 percent to 36.1 percent. (The proportion of total vested benefits accrued by women was 37.9 percent in 1983.) These gains were in keeping with the increase in the share of female employment from 43.1 to 45.4 percent of all workers.

The number of women meeting ERISA standards for plan participation also grew considerably as full-time employment became more prevalent. In 1979 only 51.3 percent of all female wage and salary workers were in the ERISA work force, compared to 63.7 percent of men. By 1983 the female percentage rose to 57.4 percent, as the proportion of men meeting ERISA standards edged up to 65.1 percent. The increase in the proportion of women in the ERISA work force represented a gain of 4.1 million workers. Coverage for this group expanded by 2.2 million workers and nearly 1.3 million more women gained entitlement to future pension benefits.

These improvements in pension protection increased the proportion of women among covere and vested workers within the ERISA work force. By 1983 over 40 percent of all covered workers and 35 percent of all future benefit recipients were women. (Women made up 37 percent of those entitled to total vested benefits, including lump-sum distributions.) The relative gains in pension coverage and benefit entitlement allocated to women stem from increased female employment and from a larger percentage of that work force meeting ERISA standards.

Despite these gains, the most striking difference in labor force characteristics between men and women has been the persistence of the wage gap. A large body of economic literature tries to explain the existence of wage differentials between men and women. Leaving these unanswered questions aside, table 5 provides greater detail on the distribution of earnings for the ERISA work force. Women are more than four times as likely to earn less than $10,000 and over twice as likely to earn less than $15,000 than men. Those earning less than $10,000 are less likely to be covered by a pension plan and more likely to have a higher Social Security replacement rate. Nonetheless, 76 percent of pension coverage is allocated to the 81 percent of the women within the ERISA work force who earn less than $20,000 a year, reinforcing the conclusion that pensions are a middle income benefit distributed closely in accordance to the income distribution.

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[4] The next section of this *Issue Brief* discusses the effect of the recession on coverage and vesting.

TABLE 5.—CUMULATIVE DISTRIBUTION OF EMPLOYMENT AND COVERAGE BY EARNINGS [1] FOR WOMEN AND MEN IN THE ERISA WORK FORCE, MAY 1983

[Employees in thousands, distribution in percent]

Earnings	Distribution of women		Distribution of men	
	Employment	Coverage	Employment	Coverage
Total employees	22,970	15,207	31,393	22,851
Less than $5,000	4.84	2.10	0.76	0.35
Less than $10,000	28.56	18.32	7.01	3.88
Less than $15,000	60.81	51.51	23.56	16.77
Less than $20,000	81.28	76.28	43.35	36.40
Less than $25,000	92.30	90.23	64.70	59.77
Less than $30,000	96.62	95.61	77.89	74.33
Less than $50,000	99.66	99.54	95.23	94.44
Total earnings	100.00	100.00	100.00	100.00

[1] Percentages exclude 4.8 percent of men and 3.1 percent of women whose earnings are not reported.

Source: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement.

New evidence on vesting

Table 6 shows that the percentage of private-sector workers with vested benefits generally increases with age. Around two-thirds of all covered wage and salary wokers forty-five years of age and older are vested. Vesting rates fall again once workers reach sixty-five years of age. The proportion of vested public-sector workers follows a similar age pattern with vesting peaking in the early 60's at 88 percent of coverage.

Using the May 1983 EBRI/HHS CPS pension supplement, vested benefits can be broken down into two complementary components for the first time: (1) entitlement to future retirement income and (2) entitlement to a lump-sum payment. The addition of lump-sum benefits increases the total vesting rate by over 10 percentage points for the private sector and by nearly 20 percentage points for public sector wage and salary workers. Comparable vesting gains are found for the ERISA work force as well. Furthermore, the age profile of entitlement to future retirement income charts a steeper path than that exhibited by total vested benefits. As a consequence, the addition of lump-sum benefits totally changes our conception of the degree of vesting provided by employer pensions.

Employees anticipate the receipt of lump-sum benefits in several ways: (1) as cash outs of their own contributions, (2) as distributions of defined contribution plan balances upon separation from the firm, or (3) through cash-out provisions for very small vested benefits from defined benefit plans. The age profile of lump-sum entitlement is the opposite to that found for benefit entitlement at retirement. A greater percentage of younger workers anticipate lump-sum cash outs. Although the expectation of lump-sum recipiency jumps at age twenty-five to 13 percent of covered private sector employees and 27 percent of covered public-sector workers, it diminishes thereafter. Private-sector rates tumble at age sixty to just 5 percent. This decline may reflect two factors. First, younger workers are more likely to change jobs, and their expectation of lump-sum entitlement probably reflects this reality. Second, younger workers may be more likely to be employed by expanding firms who have recently instituted defined contribution plans.

Lump-sum entitlement among public sector employees is nearly twice as high as that in the private sector. Within the ERISA work force, more than one-fifth of all covered public employees expect to receive only a lump-sum benefit, compared to less than one-eighth of those covered under private-sector employment (see table 6). The higher public-sector rate reflects the greater prevalence of contributory plans which may be cashed out upon termination of employment.

TABLE 6.—VESTING AMONG NONAGRICULTURAL WAGE AND SALARY WORKERS AND THE ERISA WORK FORCE BY AGE AND SECTOR, MAY 1983

Age	Covered workers (thousands)	Percent vested of covered		
		Total percent vested of covered	Percent entitled to future benefit	Percent entitled to lump sum only
Nonagricultural wage and salary workers:				
Private sector	36,458	51.02	40.32	10.69
Less than 25	5,285	19.63	11.87	7.77
25 to 34 years	11,516	42.80	29.47	13.34
35 to 44 years	8,576	59.77	48.61	11.16
45 to 54 years	6,185	67.41	56.45	10.96
55 to 59 years	2,912	69.88	62.53	7.35
60 to 64 years	1,520	69.97	64.88	5.08
65 years and older	465	51.28	45.82	5.46
Public sector	13,072	77.33	57.50	19.45
Less than 25	1,092	45.67	28.25	17.43
25 to 34 years	3,723	73.66	46.56	27.10
35 to 44 years	3,656	82.89	61.50	21.39
45 to 54 years	2,552	83.32	68.33	14.99
55 to 59 years	1,159	84.05	72.43	11.62
60 to 64 years	664	88.07	76.56	11.51
65 years and older	227	67.17	59.25	7.92
ERISA work force:				
Private sector	27,550	60.11	48.21	11.90
25 to 34 years	9,883	46.81	32.33	14.48
35 to 44 years	7,779	63.07	51.38	11.69
45 to 54 years	5,756	70.11	58.72	11.39
55 to 59 years	2,708	73.13	65.38	7.75
60 to 64 years	1,424	70.98	65.91	5.07
Public sector	10,507	84.90	64.20	20.69
25 to 34 years	3,184	78.08	49.72	28.36
35 to 44 years	3,261	88.22	66.30	21.92
45 to 54 years	2,365	86.39	71.36	15.03
55 to 59 years	1,082	87.81	76.29	11.52
60 to 64 years	616	91.70	79.29	12.40

Source: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement.

Public-sector rates of future benefit entitlement within the ERISA work force avarage over one-third higher then private-sector rates. These factors lead to nearly a 25 percentage point spread between private sector and public sector total vesting rates. Public sector vesting runs at just under 85 percent of coverage and that of the the private sector just passes 60 percent. These higher vesting rates, however, mask one characteristic of many public plans. Public pensions are often the only source of coverage for government employees. At the tome of the survey, no federal workers participated in Social Security and neither did 43 percent of the state and local work force.

Vesting vs. voluntary contributions.—A comparison of total vested benefits for private nonagricultural wage and salary earners (from table 6) with seciton 401(k) and IRA utilization rates (from table 7) shows the relative difference between coverage selected by the individual worker and that provided by employer pension plans. Utilization of IRAs for every age group is far below the proportion of vested benefits provided by private-sector employers. The utilization of 401(k) plans among wage and salary workers is comparable at very young and very old ages to vesting rates provided by private sector pension plans. Private plans provide considerably greater vesting for workers between twenty-five and sixty years of age than workers provide for themselves under 401(k) arrangements. Pension plan vesting rates exceed section

401(k) participation rates by over 15 percentage points for the ERISA work force between thirty-five and fifty-nine years of age.

TABLE 7.—UTILIZATION OF VOLUNTARY RETIREMENT PROGRAMS AMONG PRIVATE NONAGRICULTURAL WAGE AND SALARY WORKERS BY AGE AND TYPE OF PROGRAM, MAY 1983

Age	Section 401(k) deferred compensation		Individual retirement accounts	
	Number offered plan (thousands)	Percent utilization	Number of workers (thousands)	Percent utilization
Nonagricultural wage and salary workers:				
Total employees	4,822	39.31	72,465	16.49
Less than 25	555	19.79	16,415	2.30
25 to 34 years	1,627	30.71	21,553	11.00
35 to 44 years	1,364	43.04	14,681	18.51
45 to 54 years	795	49.51	10,627	30.25
55 to 59 years	302	56.90	4,723	39.90
60 to 64 years	139	68.13	2,834	37.13
65 years and over	([1])	([1])	1,630	20.30
ERISA work force:				
Total employees	3,833	43.68	42,458	21.96
25 to 34 years	1,404	33.75	15,977	11.87
35 to 44 years	1,262	44.42	11,479	19.57
45 to 54 years	749	50.96	8,781	30.55
55 to 59 years	281	58.35	3,919	41.21
60 to 64 years	138	68.65	2,302	38.32

[1] Number of workers too small for rates to be calculated reliably.

Source: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement.

In sum, new findings from the May 1983 EBRI/HHS CPS pension supplement show that vested benefits for employer plans exceed previously reported vesting rates by 10 to 20 percent when lump-sum distributions are added to benefit entitlement at retirement. Furthermore, comparisions with new data on voluntary participation in IRAs and 401(k) plans suggest that employer pensions provide a greater degree of coverage for workers at younger ages than they would provide for themselves.

The costs of the business cycle

The timing of the May 1983 EBRI/HHS CPS pension supplement provided the first opportunity to analyze the sensitivity of employer pension plans to business cycle conditions. The predecessor survey, the May 1979 DOL/SSA CPS pension supplement, was conducted during relatively boyant economic times. According to the National Bureau for Economic Research, a 58 month economic expansion was in full swing in May 1979 as the economy surged toward its January 1980 cyclical peak just eight months later. By contrast, four years later in May 1983, the economy had just passed the November 1982 cyclical trough marking the most severe recession since World War II.

The period between the surveys was not one of strong economic growth. Real Gross National Product expanded at less than a 1 percent annual rate between the second quarter of 1979 and the second quarter of 1983. Furthermore, the consumer Price Index increased at an average annual rate of 8.2 percent between May 1979 and May 1983. Although prices moderated considerably by 1982, the sequence of double digit inflation and severe recession would be expected to have a marked effect on every sector of the economy.

A sharp economic downturn is unlikely to lead to robust plan growth. As the economy headed toward the recessionary trough, employers would be unlikely to add to compensation costs by instituting new pension plans where none were previously available. Similarly, employees who had suffered real wage losses during the inflationary spiral would be unwilling to agree to trade current comepensation for future pension benefits. While some employees might choose tax-sheltered deferred compensation from a second plan in lieu of current salary increases, probably most would not. *A priori*, growth in pension coverage could not be expected between May 1979 and May 1983.

The fate of employer pensions is closely linked to the labor market. The difference in unemployment rates between the two pension supplement surveys is striking. In May 1979, the civilian unemployment rate reached its lowest point since the passage of ERISA, at a seasonally adjusted rate of 5.6 percent. By contrast, the civilian unemployment rate for May 1983, at 10.1 percent was one of the highest since before World War II. (Nationwide double digit unemployment had disappeared in this country after the Great Depression ran its course.) while the unemployment rate eased to 7.1 percent by June 1984, the EBRI/HHS May 1983 CPS pension supplement took place in mid-1983 before the beginning of the recent robust expansion.

The aggregate figures

Table 8 presents data on employment, pension coverage and future benefit receipt for five employment groups in May 1979 and May 1983. The figures range from the broadest definition of employment, that of all civilian employees plus the self-employed, narrowing to the ERISA work force, those employees meeting ERISA standards for plan participation in 1983. This latter group is most likely to represent workers who will have enough years of service to build an adequate employment-based pension. In table 8, the ERISA work force is gradually augmented to include those on their current job for less than a year, those working fewer than 1,000 hours, those workers under age twenty-five and over age sixty-five, and, finally, agricultural workers and the self-employed.

TABLE 8.—EMPLOYMENT, COVERAGE AND FUTURE BENEFIT ENTITLEMENT BEFORE AND AFTER THE RECESSION, MAY 1983 AND MAY 1979

[Employment in thousands and percent of employment in parentheses]

	Employment	Coverage	Future benefit entitlement
1983			
Civilian employment (all employees and self-employed)	98,964 (100.00)	51,530 (52.07)	24,095 (24.35)
Nonagricultural wage and salary workers	88,214 (100.00)	49,530 (56.15)	22,217 (25.19)
Nonagricultural wage and salary workers age 25 to 64 only	68,252 (100.00)	42,463 (62.21)	20,934 (30.67)
Nonagricultural wage and salary workers age 25 to 64, working 1000 hours or more	61,586 (100.00)	40,702 (66.09)	20,476 (33.25)
ERISA work force (age 25 to 64, working 1000 hours or more, one year of tenure or more)	54,363 (100.00)	38,057 (70.01)	20,027 (36.84)
1979			
Civilian employment (all employees and self-employed	95,372 (100.00)	53,445 (56.04)	22,633 (23.73)
Nonagricultural wage and salary workers	85,181 (100.00)	52,019 (61.07)	21,399 (25.12)
Nonagricultural wage and salary workers age 25 to 64 only	63,201 (100.00)	42,576 (67.37)	19,836 (31.39)
Nonagricultural wage and salary workers age 25 to 64, working 1000 hours or more	58,009 (100.00)	40,830 (70.39)	19,522 (33.65)
ERISA work force (age 25 to 64, working 1000 hours or more, one year of tenure or more)	49,736 (100.00)	36,890 (74.17)	18,941 (38.08)

Source: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement and May 1979 DOL/SSA CPS pension supplement.

The data show that the coverage rate for the ERISA work force, at 70 percent, is higher than that of any of the expanded employment groups. This finding is consistent with the economics of the labor market and retirement planning. ERISA participation standards were set on the following premises: (1) the labor force attachment of many part-time employees and those with less than a year on the job may be too weak to build up meaningful pension benefits; (2) workers less than twenty-five years of age are likely to have high turnover rates as they start their careers; and (3) those over sixty-five are more likely to be retired and employed at a part-time job. Farm workers are segmented out because they tend to have low wages and transient employment. Although the non corporate self employed may establish a Keogh plan, more than 95 percent do not, probably preferring the reinvest their funds in the growth of their own company.

The comparative findings of the May 1983 and the may 1979 surveys are thought-provoking. Employment of nonagricultural wage and salary workers (the second row on table 8 for each year) increased by 3 million employees between the 1979 and 1983. On the one hand, pension coverage did not keep up with this trend and fell by nearly 2.5 million workers primarily through a drop in coverage among employers under age twenty-five and sixty-five years and older. On the other hand, the number of workers who anticipate benefit entitlement at retirement increased by over 800,000. In other words, even though aggregate coverage among wage and salary workers fell after the 1982 recession, benefit entitlement remained strong. Nevertheless, because of the labor force expansion, coverage and vesting rates both declined regardless of increases in the number of covered and entitled workers.

Changes in the ERISA work force (the last row in table 8 for each year) between 1979 and 1983 tell a different story. Employment gains between the two years were even stronger with 4.6 million workers added to the ERISA work force. The number of covered workers also grew by over one million employees to 38 million workers. Gains in vesting surpassed one million to total 20 million workers. (And, of course, these figures omit the additional 5.5 million employees who anticipate receiving a lump-sum benefit.) Nonetheless, both coverage and vesting rates declined from their 1979 rates. By 1983, the coverage rate for the ERISA work force was 70 percent with 53 percent of covered workers of all ages anticipating future benefit receipt. In 1979 coverage for the ERISA work force had reached 74 percent, although only 51 percent of covered workers anticipated benefits at retirement.

The reasons behind these changes are not easily analyzed. The first apparent conundrum is the issue of declining coverage among nonagricultural wage and salary workers during a period of increasing employment. As table 8 shows, most of the decline in the number of covered nonagricultural workers falls among workers under twenty-five years of age and sixty-five years and older. The most perplexing question arising from the EBRI/HHS May 1983 CPS pension supplement findings is why gains among the ERISA work force did not keep pace with increases in employment.

An industrial analysis

Part of the explanation for the fall in pension coverage rates despite expanding employment lies in the effect the recession had on employment by industry. Typically, manufacturing has been considered a high coverage industry and the service sector a low coverage industry. Industrial shifts between services and manufacturing could bring about the decline in the coverage rate observed in 1983.

Tables 9 and 10 present statistics on employment and coverage for the ERISA work force for May 1979 and May 1983 and data on certain employment-related characteristics.[5] Industries are presented in two groupings: recessionary sectors and growth sectors. In general, the recessionary sectors are comprised of the older industrial infrastructure, including manufacturing, which exhibited employment losses. The growth sectors are heavily weighted toward those service-related industries which experienced employment growth.

TABLE 9.—CYCLICAL CHANGES IN EMPLOYMENT AND COVERAGE IN THE ERISA WORK FORCE BY INDUSTRY, MAY 1979 AND MAY 1983

[Amounts other than percent in thousands]

Industry	Employment 1983	Employment change 1979–83	Coverage change 1979–83	Percent covered	
				1979	1983
Recessionary sectors:					
Government	11,905	750	93	93.36	88.26
Durable manufacturing	8,492	(446)	(795)	84.74	79.84
Primary metals	702	(257)	(251)	91.98	89.81
Automobiles	823	(190)	(155)	90.48	92.56

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[5] Changes in the 1970 and 1980 Censuses mean that employment totals for the May 1979 CPS and the May 1983 CPS are strictly comparable. In particular, the 1980 Census corrected a previous undercount, so that were the 1979 CPS benchmarked to the latest Census, the population totals would be somewhat higher. That implies that employment increases may be slightly too robust and employment decreases may be slightly underrepresented. Thus the recessionary impact on coverage may be understated. The effect of this undercount on calculated rates should be minimal.

TABLE 9.—CYCLICAL CHANGES IN EMPLOYMENT AND COVERAGE IN THE ERISA WORK FORCE BY INDUSTRY, MAY 1979 AND MAY 1983—Continued

[Amounts other than percent in thousands]

Industry	Employment 1983	Employment change 1979–83	Coverage change 1979–83	Percent covered	
				1979	1983
Nondurable manufacturing	5,862	321	([1])	77.08	72.56
Apparel	697	(175)	(84)	46.21	45.82
Chemicals	970	(104)	(109)	93.17	91.89
Transportation (ex-railroads)	1,454	([1])	(82)	72.64	68.98
Construction	2,130	(102)	(295)	55.75	44.56
Growth sectors:					
Public utilities	811	159	129	96.06	93.11
Communications	1,200	277	215	92.04	88.75
Mining	660	177	117	88.73	82.72
Finance, insurance, and real estate	3,444	581	435	71.94	72.42
Professional service	6,401	1,578	961	64.96	63.95
Wholesale trade	2,682	403	138	68.36	63.26
Retail trade	5,833	503	182	46.89	45.96
Business and personal services	3,184	668	225	33.87	33.83

[1] Number of workers too small to be statistically significant.

Source: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement and May 1979 DOL/SSA CPS pension supplement.

TABLE 10.—CYCLICAL CHANGES IN EMPLOYMENT CHARACTERISTICS OF THE ERISA WORK FORCE BY INDUSTRY, MAY 1979 AND MAY 1983

Industry	Average tenure with employer (years)		Covered by union contract (percent)		Large company: 500 or more workers (percent)	
	1979	1983	1979	1983	1979	1983
Recessionary sectors:						
Government	10.54	10.59	50.05	52.54	([1])	([1])
Durable manufacturing	12.12	11.42	45.18	35.49	77.32	72.38
Primary metals	15.65	14.06	64.97	55.17	83.93	85.79
Automobiles	13.02	15.22	72.70	59.21	92.41	88.28
Nondurable manufacturing	11.76	10.68	39.96	32.39	71.24	69.10
Apparel	9.21	7.90	43.03	34.83	48.93	57.31
Chemicals	13.54	12.12	32.09	22.35	85.41	88.24
Transportation (ex-railroads)	10.89	9.57	52.00	40.72	59.74	57.94
Construction	9.04	8.24	42.08	31.07	26.79	24.07
Growth sectors:						
Public utilities	14.95	13.96	50.34	42.58	85.42	81.96
Communications	14.39	13.08	59.56	58.49	87.07	84.02
Mining	11.14	10.27	41.87	28.57	80.40	76.57
Finance, insurance and real estate	9.74	8.23	6.78	5.10	56.45	59.21
Professional services	7.63	6.87	12.22	13.04	42.66	41.81
Wholesale trade	9.60	9.45	15.38	13.82	39.97	36.99
Retail trade	8.49	7.49	16.37	14.43	42.86	45.74
Business and personal services	8.68	6.27	13.02	10.80	34.74	31.81

[1] Data on firm size not applicable to Federal Government employment.

Source: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement and May 1979 DOL/SSA CPS pension supplement.

The recessionary sectors.—The recessionary sectors include manufacturing, transportation (excluding railroads),[6] construction and government. Between 1979 and

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[6] Following past survey practices, respondents were instructed to exclude Social Security and Railroad Retirement from their responses.

1983, most of these industries exhibited strong across-the-board declines in employment or significant downturns within major components. Government is the only sector with growth in employment and coverage. It is among those affected by the recession, however, since weak economic growth and high inflation undoubtedly influenced the public's desire to reduce taxes and government spending.

The bulk of employment in the recessionary sectors of the economy is typified by pension coverage rates of over 70 percent. Employment and coverage losses were significant. Led by construction industry declines of over 11 percentage points, these sectors all showed coverage rate reductions of 3 to 5 percentage points. Yet in each industry the complex set of factors influencing the decline in the coverage rate differed.

For instance, two primary sources of employment and coverage loss among the durable goods manufacturing industries were primary metals (representing the steel industry, for the most part) and automobiles. Coverage losses in these industries alone accounted for more than half the total losses in durables manufacturing. Yet the coverage rate for auto workers did not decline because of significant plant closings and broadly based layoffs and permanent separations. The rest of durables manufacturing provides an example of a more standard recessionary adjustment process. As many workers in large unionized firms were laid off during the 1982 recession, employment fell but coverage fell even more leading to lower coverage rates. Coverage rates today should be higher to the extent that laid-off workers were rehired as the recovery gained momentum.

While many other industries were affected by a variety of special factors, coverage rates in government were particularly depressed in comparison to the private sector. Whereas the government coverage rate fell 5.1 percentage points from 93.4 to 88.3 percent, the coverage rate for all private sector industries only slipped 3.7 percentage points from 68.6 to 64.9 percent. In particular, the federal government appears to have hired more workers outside of the Civil Service Retirement System. Although specific recessionary and growth industries, such as construction and mining, also posted large coverage rate losses in percentage terms, the government figures are particularly striking in view of pension coverage rates that traditionally have been nearly universal.

Table 10 provides part of the framework for a more general analysis of these changes. Three factors found to influence coverage rates are provided by industry for 1979 and 1983. These factors consist of average on-the-job tenure, the likelihood of being included in a union contract, and the likelihood of being employed by a company employing 500 or more workers. Industries with long-tenure workers tend to have greater pension coverage both because employers want to provide benefits for long-tenure employees and because employees want to work longer at firms with pension benefits. Large firms tend to establish pensions more readily because of scale economies in personnel and asset management. Unionization is closely tied to pension protection. Benefits have been a subject of collective bargaining for many years and multiemployer agreements increase the scale economies of pension providion by banding together smaller contributions within the Taft-Hartley plan.[7]

Within the recessionary sectors, declines have taken place in average tenure, unionization and the extent of employment in large firms. Shifts in unionization and firm size are probably a result of layoffs in larger more highly unionized plants. Unionized firms appear more ready to reduce costs through temporary layoffs during a recession rather than through across-the-board wage cuts. In May 1983, those laid-off workers were either collecting unemployment insurance, or, if reemployed, working at smaller less-unionized firms.

The growth sectors.—With the exception of mining, sectors exhibiting employmenit gains were all within the service-providing industries. Table 8 shows that these 8 major industry groups led to an increase in employment of 4.3 million workers between 1979 and 1982. The number of covered workers in these industries expanded by 2.4 million employees. While the service sector is typically regarded as a source of low-wage low-benefit employment, 6.1 million workers, or 25 percent of the growth sector, are in industries with coverage rates of over 70 percent. Another 9 million workers, or 37.5 percent of this work force, are in industries with coverage rates of over 60 percent. Two patterns of change are exhibited: coverage rates for half the industries fell while those for the other half held constant.

Public utilities, communications, mining and wholesale trade exhibited declines in coverage rates despite an increase of nearly 600,000 in the number of covered workers in those industries. In the mining and public utilities, significant declines in the extent of unionization, combined with a shift toward smaller companies, may have led to the decline in the coverage rate. Nevertheless, in 1983, coverage rates for three of these four industries surpassed 80 percent even during this recessionary period.

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[7] Olivia S. Mitchell and Emily S. Andress, "Scale Economies in Private Multi-Employer Pension Systems", "Industrial and Labor Relations Review," July 1981, pp. 522–530.

Coverage rates held virtually constant in the financial sector (finance, insurance, and real estate), in the services (professional services and business and personal services) and in the retail trade. The number of covered workers increased by a hefty 1.8 million employees. In other words, depsite a variety of factors militating toward lower coverage, including the recession and some tendency toward shorter job tenures, coverage rates did not decline. Over three-quarters of these workers were found in the financial sector and in professional services which posted coverage rates of 72 and nearly 64 percent respectively.

In summary, losses in employment and coverage stemming from a recessionary economy differed significantly according to industry. In some industries, the survey missed enumerating out-of-work covered workers who did not experience a break-in-service. By now, pension coverage has rebounded in those sectors as manufacturing workers returned to their jobs during the expansion.

Employment growth in the service-related sectors was robust in view of the recessionary conditions. In absolute numbers, millions of covered workers were added to that sector alone, taking up much of the loss suffered in manufacturing. Many service sector coverage rates were remarkably stable. Slower pension coverage growth would be expected during a recession. New employers would be less likely to provide a pension in their compensation package; old employers would be less likely to institute a pension if they did not have one. Furthermore, some argument could be made that lower cost employers, those without pensions, may find it easier to expand during a cyclical downturn.

Statistical quirks

Unfortunately an industrial analysis does not seem to answer all the questions about what happened to pension coverage between the two surveys. A number of purely statistical issues make the data difficult to interpret and perhaps suggest that pension coverage remained more robust than indicated by the raw percentages. While changes in coverage appear to be associated with the extent of unionization, average job tenure and firm size, the decline in coverage within the ERISA work force appears surprisingly broad in view of the relatively small compositional changes in many of those variables affecting coverage rates.

For this reason a preliminary statistical analysis was conducted for those members of the ERISA work force with valid responses for all items used in the analysis.[8] The regression included factors likely to affect pension coverage to explain the change in the coverage rate. Variables similar to those in table 9 were found to influence the extent of pension coverage as well as industry, earnings and to a lesser extent, age and geographic region of the country.

In addition to service sector growth and a contraction in manufacturing, changes took place in the distribution of age, tenure and earnings within the ERISA work force between the two survey years. This preliminary analysis indicated a downward shift in the structure of the determinants of pension coverage not related to differences in the compositional shifts in the work force. This may represent the effect of the recession ón pension growth.

Imputed responses.—A further explanation for the shift in the structure of the coverage equation and the coverage rate may lie in the distribution of unreported responses in the survey. In 1980, the President's Commission on Pension Policy contracted with ICF, Inc. to allocate missing answers to the May 1979 DOL/HHS CPS pension supplement resulting from question refusals, skipped questions and 'don't know' responses.[9]

Table 11 presents statistics on employment, coverage and future benefit receipt for 1979 and 1983 comparable to those presented in table 8 but using imputations to fill in missing or incomplete data. For both years, the imputed responses for items that were not reported leads to an increase in the number of persons covered by a pension plan and in the number of persons who anticipate the receipt of future pension benefits. The survey findings using the imputed data differ for coverage and for benefit receipt because of different patterans of nonresponse for the two questions.

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[8] Final findings will be presented in Emily S. Andrews, "The Changing Profile of Pensions in America," (Washington, DC: EBRI, forthcoming).

[9] More ambitious imputations for those individuals who were eligible for the survey but did not respond to any of the pension supplement questions were not included.

Many more employees did not know whether they were entitled to future pension benefits.

TABLE 11.—EMPLOYMENT, COVERAGE AND FUTURE BENEFIT ENTITLEMENT BEFORE AND AFTER THE RECESSION, MAY 1983 AND MAY 1979 [1]

[Employment in thousands and percent of employment in parentheses]

	Employment	Coverage	Future benefit entitlement
1983			
Civilian employment (all employees and self-employed)	98,963 (100.00)	56,018 (56.60)	30,850 (31.17)
Nonagricultural wage and salary workers	88,214 (100.00)	53,932 (61.14)	28,894 (32.75)
Nonagricultural wage and salary workers age 25 to 64 only	68,252 (100.00)	45,379 (66.49)	26,569 (38.93)
Nonagricultural wage and salary workers age 25 to 64, working 1000 hours or more	63,833 (100.00)	43,723 (68.50)	26,143 (40.95)
ERISA work force (age 25 to 64, working 1000 hours or more, one year of tenure or more)	56,153 (100.00)	40,441 (72.02)	25,326 (45.10)
1979			
Civilian employment (all employees and self-employed)	95,372 (100.00)	55,515 (58.21)	29,309 (30.73)
Nonagricultural wage and salary workers	85,181 (100.00)	54,079 (63.49)	28,005 (32.88)
Nonagricultural wage and salary workers age 25 to 64 only	63,201 (100.00)	43,907 (69.47)	26,009 (41.15)
Nonagricultural wage and salary workers age 25 to 64, working 1000 hours or more	59,217 (100.00)	42,252 (71.35)	25,512 (43.08)
ERISA work force (age 25 to 64, working 1000 hours or more, one year of tenure or more)	50,562 (100.00)	37,803 (74.77)	24,494 (48.44)

[1] Figures include imputations for missing data.

Source: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement and May 1979 DOL/SSA CPS pension supplement using imputations provided by ICF Inc.

While the number of covered workers increased for both years using the imputed variables, the increase in coverage is greater for 1983 than 1979. Analysis suggests that more high salaried workers, more employees in government, and more persons working in large firms were among those without reported responses in 1983. The reason for this shift in nonresponse has not been identified. Suffice it to say that although more wage and salary workers were covered in 1979 than in 1983, using the imputed responses, the gap in coverage fell from 2.5 million workers to under 150,000. Coverage increased to 53.9 million workers in 1983 or 61 percent of all nonagricultural employees.

Between 1979 and 1983, coverage rose by 2.6 million employees for the ERISA work force using the imputed data, compared to an increase of just over 1.1 million based on the CPS raw counts. Part of this greater coverage growth resulted from the addition of 1.8 million workers to the ERISA work force for May 1983 after imputations were made for missing responses to job tenure and annual hours worked. This raised the proportion of employment in the ERISA work force from 55 to 57 percent. Furthermore, even though the coverage rate fell between 1979 and 1983, the decline was smaller using imputed data.

Imputations improve the status of future benefit receipt within the population even more. This results from the large fraction of the population which reported that they did not know whether they were qualified for retirement benefits. In 1979 nearly 15 percent of covered nonagricultural employees and the covered members of ERISA work force had not reported whether or not they would be entitled to a benefit at retirement. Although the figure fell to around 12 percent in 1983, suggesting greater employee information about pensions, the degree of nonresponse remained substantial.

Imputed data on future benefit receipt increased the number of workers vested for retirement benefits for both years but did not greatly alter the relationship between the two years. Concentrating on May 1983, the data indicate that the imputations increased the number of workers expecting retirement benefits by 6.7 million to a total of 28.9 million workers. Within the ERISA work force the number of workers looking forward to a pension rose by 5.3 million to 25.3 million workers. Thus 63 percent of covered workers of all ages were eligible for retirement benefits. If the 5.5 million persons in the ERISA work force who expect lump-sum benefits are added to this sum, the number of total vested workers rises to 30.8 million or 76 percent of all covered employees of all ages meeting ERISA participation standards.

The full picture

Evaluating changes in coverage and future benefit receipt between the May 1979 DOL/SSA CPS pension supplement and the May 1983 EBRI/HHS CPS pension supplement is a complex task. The dual effects of unfavorable economic conditions and changing patterns of survey response must be considered. On the one hand, changes in response patterns between 1979 and 1983 appear to minimize the growth in the number of covered workers and maximize the decline in the coverage rate.[10] On the other hand, even using imputed responses, pension coverage did not keep up with employment gains during a period of massive unemployment and low economic growth. This resulted in a decline in the ratio of covered workers to employment between May 1979 and May 1983.[11]

Coverage rates posted in May 1983 were adversely affected by the 1982 recession in several ways. First, many workers in manufacturing were on layoff lowering the overall coverage rate. Second, this effect may have been compounded to the extent that unionized employment responded to the recession through layoffs rather than wage cuts. Third, employers without a pension plan would have been unlikely to institute one during a period of high unemployment and lagging demand. Plan growth among employers without coverage should accelerate during the current expansion to a rate more in keeping with a long run expansion path.

Even though the expansion of coverage was not proportional to the expansion of employment causing the coverage rate to edge off from 75 percent in May 1979 to 72 percent in May 1983 using imputed responses, the number of covered workers expanded by 2.6 million workers for the ERISA work force. This expansion indicates that even during adverse conditions employer pensions have continued to provide protection for the majority of employees meeting ERISA participation standards.

Even during a recession pension plans continue to cover predominantly lower- and middle-income workers. Table 12 compares the distribution of employment, coverage and pension receipt by earnings for the ERISA work force in 1979 and 1983. Although the proportion of workers earning less than $25,000 (in 1983 dollars) increased from 74 percent in 1979 to 76 percent in 1983, the proportion of covered workers earning less than $25,000 also increased from 70 percent in 1979 to 72 percent in 1983. Furthermore, the proportion of workers expecting future retirement benefits (excluding lump sum distributions) and earning less than $25,000 increased from 63 percent of all workers in 1979 to 67 percent in 1983. In other words, pension coverage continues to protect middle-income employees even as the income distribution worsened.

TABLE 12.—CUMULATIVE DISTRIBUTION OF EMPLOYMENT, COVERAGE AND VESTING BY EARNINGS [1] FOR THE ERISA WORK FORCE, MAY 1979 AND MAY 1983

[Employment in thousands, distribution in percent]

Earnings [2]	Employment distribution	Coverage distribution	Benefit entitlement distribution
1983			
Total employees [1]	54,363	38,058	20,027
Less than $5,000	2.50	1.05	0.54
Less than $10,000	61.21	9.67	5.98
Less than $15,000	39.46	30.70	23.82
Less than $20,000	59.54	52.39	44.85
Less than $25,000	76.48	71.98	66.67
Less than $30,000	85.89	82.86	78.85
Less than $50,000	97.13	96.48	95.23
Total earnings	100.00	100.00	100.00

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[10] There is also some evidence that a change in the wording of the key coverage question may have led to a decline in reported coverage. The 1983 survey substituted the phrase "contribute to a pension plan" for "have a pension plan."

[11] Other surveys of pension coverage also show coverage rates edging off since 1979. These include calculations of prior year pension coverage among employed workers from the annual March Current Population Survey and pension coverage among large and medium-sized firms from the Bureau of Labor Statistics' Level of Benefits Survey.

TABLE 12.—CUMULATIVE DISTRIBUTION OF EMPLOYMENT, COVERAGE AND VESTING BY EARNINGS [1] FOR THE ERISA WORK FORCE, MAY 1979 AND MAY 1983—Continued

[Employment in thousands, distribution in percent]

Earnings [2]	Employment distribution	Coverage distribution	Benefit entitlement distribution
1979			
Total Employees	49,736	36,890	18,941
Less than $5,000	1.86	0.82	0.26
Less than $10,000	14.33	8.74	5.06
Less than $15,000	36.19	28.72	21.15
Less than $20,000	57.18	50.59	42.76
Less than $25,000	74.22	69.95	63.34
Less than $30,000	85.17	82.57	77.45
Less than $50,000	97.43	97.07	96.09
Total earnings	100.00	100.00	100.00

[1] Percentages excluded 4.9 percent of employees in 1979 and 4.1 percent of employees in 1983 whose earnings are not reported.
[2] In 1983 dollars.

Source: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement and May 1979 DOL/SSA CPS pension supplement.

Furthermore, the employer pension system did not suffer the financial difficulties experienced by the Social Security system in recent years. Between 1979 and 1982 Social Security trust fund assets fell from $24.7 billion to $22.1 billion and would have run out had interfund transfers not taken place and had the 1983 Social Security Amendments not been passed. This unfortunate situation was a direct result of sluggish economic growth with wage rates lagging prices over an extended period. By contrast, assets held by private, state and local government plans continued to grow. Accumulated holdings in these employer pension funds were $522.9 billion in 1979 and $815.8 in 1982 despite a sluggish economy. While no employed workers lost Social Security coverage during the recession, the costs to maintaining benefit entitlement for a system that was not self-regulating at the time were borne by workers and retirees alike through the 1983 Amendments.

Conclusion

Pension coverage appears to be sensitive to business conditions, exhibiting less rapid growth during cyclical downswings. Employer pensions continued to provide coverage, however, to the vast majority of workers who are most likely to accrue meaningful benefits no matter the state of the economy. These employees vest in their pension plans as they grow older, probably accruing benefits at a faster rate than they would on their own. Furthermore, more and more women have become entitled to pensions in their own right as they enter the labor force in greater numbers. Finally, the vast majority of employees benefiting from employer pension plans continue to be middle income workers earning less than $25,000 a year. All these benefits are observed in a system with strong financial reserves enabling it to weather the worst depression in four decades.

STATEMENT OF THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

The Associated General Contractors of America AGC represents more than 30,000 firms, including 8,400 of America's leading general contracting companies which are responsible for the employment of more than 3,400,000 individuals. These member contractors perform more than 80 percent of America's contract construction of commercial buildings, highways, industrial and municipal-utilities facilities and of the contract construction performed by American firms abroad. We appreciate the opportunity to submit written testimony regarding the federal tax treatment of employer provided fringe benefits.

AGC supports the long established national policy of excluding fringe benefits from taxation at the employee level while allowing employers to deduct the cost of the benefits as a business expense. AGC also believes that the tax treatment of nonstatutory fringe benefits has been more than adequately addressed in recent legislation. Rather than imposing more restrictions, traditional provisions of the Code such as Section 127 education expense deductions should be renewed. The reforms and the numerous restrictions covering statutory fringe benefits in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and the Tax Reform Act of 1984 (TRA) have made the present tax treatment of fringe benefits the most restrictive in modern history. Any further restrictions of employer provided fringe benefits will only serve to dismantle the efficient private sector benefit program. This system has no rival in any public sector system.

TEFRA dramatically reduced and froze the maximum contribution amounts for pension and profit sharing plans. This freeze was extended in the 1984 TRA. New "top heavy" plan rules were incorporated into the Code to limit the benefits of senior corporate officials. Severe restrictions were placed on voluntary employee benefit trusts in the 1984 Act. Reserve account restrictions were also established for a variety of benefit categories by the 1984 Act. The 1984 Act also required extensive recordkeeping and compliance requirements for employers furnishing general fringe benefits, such as merchandise discounts and working condition fringes.

AGC continues to believe that the traditional national policy of encouraging employer provided fringe benefits should be followed. This policy correctly attempts to develop and foster a private employer benefit system. The clear acknowledgement of the superiority of a private system is well founded. The needs of a local workforce are best met at the employer level. This system allows employers to tailor their benefit programs to their employees specific needs on a local basis. For example, if the workforce is relatively young, medical insurance covering family needs may be a high priority of the employees. These needs can be easily adjusted for by the employer in designing a benefit program. This flexibility enhances the efficiency of the private sector system in a way that no public system can match. Restricting this flexibility with limitations on maximum medical insurance benefits as has been suggested recently does not serve the public interest. If two similar workforces requiring the same level of benefits are located in areas where the service costs very significantly a cap will restrict the benefits of one group more than another. We do not believe the marginal revenue gains of the federal treasury justify the discriminatory effects on benefits and employees.

The clear superiority of the private sector delivery systems versus public systems represents revenue savings to the federal government which are far more significant than the tax revenues which could be raised by taxing fringe benefits. The present system has been extensively reformed in recent years and no further restrictions of the system are in the public interest.

Statement of the Associated Specialty Contractors, Inc.

INTRODUCTION

The Associated Specialty Contractors, Inc., is an "umbrella" organization of eight national associations of construction specialty contractors, whose combined membership totals about 25,000 firms. The member associations are the Mason Contractors Association of America (MCA), the Mechanical Contractors Association of America (MCAA), the National Association of Plumbing-Heating-Cooling Contractors (NAPHCC), the National Electric Contractors Association, Inc. (NECA), the National Roofing Contractors Association (NRCA), the Painting and Decorating Contractors of America (PDCA), and the Sheet Metal and Air Conditioning Contractors' National Association (SMACNA). All chapters, local and regional affiliates and contractor members of the affiliated associations are regarded as affiliates of ASC.

The segments of the industry represented by ASC affiliates, as reported in the 1977 Census of Construction Industries, consist of about 165,000 business establishments with annual sales of about $63 billion and 1,300,000 employees.

OVERVIEW

The purpose of these hearings, fringe benefit taxation, should not come as a surprise to those in the business community after reviewing the recent tax debate. Congress and the Administration are in pursuit of budget revenues and no stone will remained unturned. This is not necessarily construction investment, and the economic health of our industry.

The Economy

Clearly the greatest problem for the construction industry is interest rates that are too high. While below the temporary peaks of the late 1970's the average interest rates of the early 1980's have been far too high, especially in relation to the much lower inflation rate. In short, the record real interest rates inhibit investment and construction from reaching its potential. While the nation's overall construction economy has improved from the depths of the recent recession, business is still not as good as in years before the recession. It is important to remember that many large urban areas' economic conditions for our industry have yet to improve from recession conditions. With interest rates again on the rise to the levels that brought on the last recession, our industry is greatly concerned with the tax and budget policy promoted by the Congress and the President.

Briefly, the policies that have given our nation record trade deficits, record budget deficits, and record real interest rates must be changed before we find our economy again in a deep recession. The new recession will be caused by too large a federal government debt. Without trying to assess blame for the current economic dilemma, ASC agrees with economic policymakers who demand we shrink the federal budget deficit as soon as possible. However, higher taxes are not the only answer. They can short-circuit the construction recovery just as fast as can higher interest rates. The formula should include no less than equal cuts in spending and revenue increases if the task is to succeed. It is important that business not be asked to bear a far greater burden through higher taxes as has been the case in the last two tax bills.

Taxes and small business

Beginning in 1982, the federal government has passed at least one major tax bill each year designed solely to increase federal revenues. The merits of each bill have been questionable but in the rush to cut deficits, inadequate attention to detail is becoming all too common. That trend continued this year with a tax package that is expected to raise over $50 billion, after subtracting new spending initiatives, during the next three years. The construction industry was especially hard hit in the recent tax bill as Congress, with the President's approval, cut investment incentives for construction projects of various types. The reason for the tax hike was not that the incentives were unnecessary for stimulating investment but because the budget debt is out of control and more revenues are needed. Indeed, there is a general perception that a huge tax hike will be first on the agenda in 1985 no matter which party's candidate is successful in November.

While high interest rates and a high federal debt harm construction, so do higher taxes resulting from short-sighted tax legislation. We disagree with those who are suggesting far higher taxes on construction and business in order to balance the budget. It can't be done on the back of small business. One member of Congress recently remarked that business is the goose that lays the golden eggs—jobs, profits, higher wages, and improved living standards, etc.—and that Congress has been all too interested in the fruits of business and not in the health of business. Without reasonable care it is too easy, and politically expedient, to hike taxes on construction and small business without making the tough decision to cut spending and inequitable income tax breaks.

Separately or in combination, the elimination or restriction of tax incentives to rehabilitation or new construction will hurt the construction industry just as it appears that the recovery is forthcoming. Recent Congressional testimony has documented that the sectoral distribution of capital spending has been concentrated in equipment rather than investment in structures. The seriousness of the unbalanced capital formation picture will only be worsened by removing the incentives currently available. While ASC clearly understands the Congress' desire to raise tax revenues, it seems inequitable to reduce or eliminate construction tax incentives during a time of fragile recovery and rising interest rates. Large tax hikes on the construction industry will not improve the construction economy or general economic growth. The fragile economic recovery in the construction industry needs continued investment incentives and lower interest rates. The Committee should recognize the importance of the contribution of the construction industry and the tax incentives that are needed for its growth. The Congress and the President should promote construction incentives to stimulate investment and jobs. Higher taxes on small business are simply counterproductive to the expressed goals of a strong economy.

Fringe benefits

Specifically, the Associated Specialty Contractors (ASC) opposes taxes on fringe benefits. As our statement has outlined, taxing small business cannot be viewed in isolated terms. When depreciation incentives, industrial development bonds, leasing incentives, and other tax incentives are cut or eliminated, it hurts the construction economy. To add to the small business tax burden with fringe benefits taxes further strains the fragile business recovery.

If Congress believes that there is wide-spread abuse in the area of fringe benefits, it should say so, identify specific abuses, and make recommendations to correct them. But to tax fringe benefits, many of which are part of the social contract between the nation, employers and employees, solely to compensate for over-spending or unwise tax policy is unfair. ASC welcomes a Congressional or Administrative review of fringe benefit packages to seek out potential abuses. If found, these abuses should be acted upon by Congress with support from the business community. But, again, we emphasize there cannot be abuses in defense contracts or other areas of the budget that are ignored if employer-employee fringe benefits are offered up for revenue purposes.

In a recently released report from its Small Business Administration Office of Advocacy, researchers examined the extent of coverage, characteristics, administrative practices and costs of pension and health care plans in small businesses. The SBA study found that benefits coverage is far less extensive for employees in small business than for workers in large businesses. Only 30 percent of employees in small firms (10 employees or less) have both health and pension benefits. In firms larger than 2,500 employees, over 95 percent of workers have both types of coverage. Insufficient profitability, benefit plan complexity, and plan costs all inhibit small business from providing or expanding benefit packages. Taxing the benefits will only cause businesses to reduce the number, extent, and variety of fringe benefit packages.

Most of our members assemble their benefit packages based on collective bargaining agreements. While these agreements vary from contract to contract, region to region, there are some similarities. They types of benefits range from job training assistance, education benefits, health and welfare benefits. In some areas travel benefits, journeyman upgrading, and scholarship funds are available. No matter what the benefits, it is very probable that if the benefits are taxed, employees acting alone or through their union representatives will seek greater benefits or higher wages to offset losses to income. The management-labor agreement may be subject to challenges as workers try to maintain an agreed upon wage and benefit package. Clearly, taxing fringe benefits will be an added financial burden on small business as labor passes on the costs of tax increases through to the business. The consumer then pays for the tax if the small business is able to pass on the added cost. Otherwise, it will become another burden for the business to absorb through reduced economic activity or lower profitability. Whatever is the result, cutting federal spending is preferable to starting a chain reaction of inflationary pressure through the overburdened small business community.

CONCLUSION

ASC believes that the driving force to tax fringe benefits and to increase taxes on a whole range of other small business activities is the desire to increase revenues. Taxing fringe benefits is not a proposal to increase the equity of the tax code or correct abuses but is simply a move to raise taxes to offset federal deficit spending. Therefore, until the case can be made that spending has been cut in an equitable manner in defense, social services, and the many other areas within the federal budget, we consider it premature to endorse further tax increases on small business and their employees. We feel that most policymakers would agree that Congress has a long way to go in income tax reform and spending cuts before new tax hikes are proposed in employee personal benefit packages.

The Associated Specialty Contractors and its members have been vocal participants in the current tax debate. We offer our assistance and counsel as the revenue picture is examined by Congress in its attempts to reduce the budget deficits. However, to view tax proposals piecemeal, separate from budget cuts, rather than in a comprehensive budgetary manner, will produce results counterproductive to tax code reform and small business equity.

STATEMENT OF THE ASSOCIATION FOR ADVANCED LIFE UNDERWRITING

SUMMARY

Tax-favored fringe benefits provide a mechanism for Congress to accomplish important, necessary social goals such as increasing the life, health and retirement coverage of workers.

Many fringe benefit and other compensation provisions discriminate against small business by providing special limits that impact negatively on small business groups and have no significant impact on large business.

Numerous benefit distinctions continue to exist between self-employed individuals and corporate employees. These distinctions should be eliminated.

Small businesses are unfairly affected by the complexity of laws and the frequency with which those laws are changed. Small business is less able to handle the administrative burden this complexity generates.

Congress should act to prevent federal agencies, such as the Internal Revenue Service, from manipulating laws through the issuance or nonissuance of regulations. Recent examples, such as the Internal Revenue Service's six-year failure to issue regulations for cafeteria plans, the created difficulties for businesses, especially smaller businesses, in utilizing statutory provisions authorized by Congress.

The limits for group-term life insurance set at $50,000 in 1964 should be increased to at least $100,000.

STATEMENT

AALU is a nationwide organization of approximately 1,100 members specializing in one or more fields of advanced life underwriting. Collectively, AALU members are responsible for annual sales of life insurance in excess of $2 billion, mostly in circumstances involving complex factual situations and often dealing with qualified retirement plans and other employee compensation techniques. Much of the work performed by AALU members is with small businesses. Consequently, AALU is in a position to speak with authority concerning the problems of the small business community with respect to fringe benefits and the private pension system.

I. Introduction

A. Importance of small business

Because much of AALU's work is with small businesses and because AALU is particularly knowledgeable concerning the use of fringe benefits by small businesses, this statement will focus primarily on the availability and use of fringe benefits by that vital segment of the economy. It should be noted at the outset that historically America has always been a community of small businessmen.

Even today small business accounts for between 39 and 50 percent of our gross national product. Over 14 million small businesses employ 60 percent of the entire national workforce and create more new jobs by far than any other sector of the economy. Of 16 million jobs added to the economy over a 10-year period, 12 million were created by small business.[1]

B. Need to address small business concerns

There is an urgent need for the direction of Congressional attention to a number of major problems concerning the provision of fringe benefits by small business. A recent study has demonstrated that pension and health care coverage is less extensive for workers in small business than for workers in large business. Only 30.9 percent of employees in small firms with fewer than 10 employees have both health and pension coverage, whereas for large employers, 95.3 percent of workers have both types of coverage. This study has indicated that, among the principal reasons for the lower pension coverage, are the high cost of setting up the plan, plan complexity, the need for costly expert advice and the constantly changing governmental regulations that create uncertainly about future costs and benefits.[2] The implicit conclusion of this study (a conclusion to which Congress has frequently failed to give legislative credence) is that small businesses are less able to cope with complex standards and administrative costs than are large businesses. The inherently costly nature of changing legislative rules imposes on small business a burden that may be intolerably high when compared to the employee benefits that are thereby generated. If, for example, a large plan spends $10,000 on expert advice to gain understanding of complex new rules, that $10,000 is a relatively low cost per employee. For a company with 10 employees, however, the cost per employee is much more substantial and often prohibitive. When one considers the added fact that the cost may be a repetitive annual one because of the frequency of new laws and regulations, the problems become even more intractable.

The importance of small business in the American economy and in the American workforce mandates that Congress change its focus regarding the development of laws and regulations on fringe benefits. The focus should be centered on the problems and concerns of small business. As is discussed in greater detail below, many of the newer Congressional approaches to fringe benefits often operate to discriminate against small business by denying such businesses that availability of such benefits on a reasonable parity with larger businesses. Thus, a substantial portion of the American workforce is being denied equal access to tax-advantaged employment benefits.

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[1] These statistics are primarily derived from the Small Business Administration. See SBA, "Facts About Small Business and the U.S. Small Business Administration" (February 1981).

[2] See Coverage, Characteristics, Administration, and Costs of Pension and Health Care Benefits in Small Businesses, Final Report, submitted to the Office of Advocacy, Small Business Administration, James Bell and Associates, Inc. and ICR Incorporated (March 1984).

C. Importance of fringe benefit tax incentives

Tax-advantaged fringe benefits are undeniably of major importance in accomplishing worthwhile social goals. It has clearly been demonstrated that tax incentives will cause employers to alter their economic behavior.[3] Special tax incentives, such as the availability of tax-free educational expenses or day care, have played a major role in stimulating employers to adopt such programs. tax incentives for qualified retirement plans constitute a classic example of this behavioral change phenomenon, with between 50 percent and 80 percent of the workforce now receiving pension coverage.[4] Without tax based motivation, the life, health and retirement coverage of our workforce would be subtantially diminished and the workers in this country would be far less secure than they are today.

Recent actions by Congress have indicated that, through pension and fringe benefit statutory amendments that are designed to capture relatively insignificant amounts of revenue, short-term budget considerations are undermining the long-term security of workers' benefits. It is important that, before there is a change in any major aspect of the employee benefit system, there should be placed on the proponents of the change a heavy burden to demonstrate need for its implementation. The laws underpinning this system reflect inherently long-term planning goals for employers and employees that will be adversely affected if changed frequently.

II. Areas requiring congressional consideration

A. Trend toward discriminatory treatment of small business employees

1. Description of trend

AALU is alarmed at an unfortunate trend in legislation involving a departure from the historic discrimination standards used in the employee fringe benefits area. The trend which is both recent and appears to be gaining momentum, involves the effective denial to the small business management level of various tax-advantaged fringe benefits that are otherwise available to their counterparts with large corporations. Recent changes to the Internal Revenue Code have denied benefits to the executives of small firms where more than a certain percentage of the total benefits are made available to them, whether or not there has been a pro rata allocation of benefits to rank and file employees or, in fact, whether or not there are rank and file employees to whom an allocation can be made. Essentially, Congress has imposed a new layer of restrictions (effectively applicable only to small business) that function in addition to the traditional nondiscrimination rules for qualified plans and selective statutory fringe benefits.

This layer of restrictions creates a situation in which executives of large corporations and of small businesses that earn the same rate of pay are not treated equivalently for fringe benefit purposes. Such discrimination is not desirable from either and economic or social point of view and is contrary to articulated public policy favoring the initiation and development of small business. If the trend is permitted to grow, the cost of operating a small business will increase while, at the same time, small business recruitment of first class talent will be severely impeded.

The trend is best exemplified by the qualified group legal services plan provisions added to the Internal Revenue Code (hereinafter, Code) by the Tax Reform Act of 1976, child care plan provisions added to the Code by The Economic Recovery Tax Act of 1981 (ERTA), the pension top-heavy rules added by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), and most recently, the cafeteria plan rules in the Tax Reform Act of 1984. The education assistance plan provisions of section 127, which expired at the end of last year, also exemplify the trend. The following is an explanation of these provisions and their impacts.

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[3] See Feldstein and Clotfelter, "Tax Incentives and Charitable Contributions in the United States: A Microeconomic Analysis," published in III Commission on Private Philanthropy and Public Needs 1393 (Dept. Treas. 1977).

[4] See, e.g., Munnell, "The Economics of Private Pensions"; (Brookings 1982).

a. Qualified group legal services plan

With the enactment of the Tax Reform Act of 1976, Congress adopted for the first time in the history of the Internal Revenue Code, restrictions on a fringe benefit that denied plan benefits to owners if they received more than a certain percentage of benefits.[5]

Under Code § 120, an employer is permitted to establish a prepaid, nontaxable personal legal services plan for its employees if certain qualification requirements are met. The provision contains standard nondiscrimination requirements with regard to eligibility and coverage, benefits and the operation of the plan. In addition, it contains a requirement that no more than 25 percent of the amount contributed during the plan year be used for the benefit of 5-percent owners. In effect, if more than 25 percent of the benefits go to this group, no one in the group may exclude the benefits received. For many small firms, this is a virtual impossibility due to the ratio of owners to common-law employees. On the other hand, a large corporation with such a plan and with hundreds of employees can easily meet the restrictions, thereby permitting corporate executives to participate and receive benefits that their small business counterparts are effectively denied.

b. Educational benefit plans

Until December 31, 1983, when Code section 127 expired, amounts paid for expenses incurred by an employer for educational assistance provided to an employee were excluded from the employee's gross income if paid or incurred pursuant to a written plan that met certain requirements and that was for the exclusive benefit of the employees. Excludable amounts included tuition, fees, and similar expenses, as well as the cost of books, supplies, and equipment paid for or provided by the employer. The provision contained certain standard nondiscrimination requirements with regard to eligibility and coverage, benefits, and the operation of the plan. In addition, section 127, which was effective for taxable years beginning after December 31, 1978, contained a requirement denying the exclusion where more than 5 percent of the benefits were paid to 5-percent owners of the business. Under these constraints, in order for a small employer to receive the advantages of an educational benefit plan, ninety-five percent of the benefits had to go to nonowners.

c. Child care plans

Under section 129 of the Code, enacted in 1981, an employee who receives dependent care assistance payments provided under an employer's written plan may exclude the payments from his or her gross income subject to an earned income limitation. The provision contains nondiscrimination requirements rules, however, the section also contains a requirement similar to that for qualified group legal services plans that not more than 25 percent of the amounts paid or incurred by the employer during the year be provided to individuals who are 5-percent owners. In effect, if more than 25 percent of the benefits go to this group, no one in the group may exclude the benefits received. Thus, once again, because it is far more difficult for a small firm to conform to this top-heavy limitation than a large one, small entrepreneurs may be effectively denied the benefit.

d. Pension plan top-heavy provisions

In 1982, TEFRA added to the Code § 416 which contained a new set of broad scale qualified plan requirements which effectively limit benefits for key employees of top-heavy plans. Essentially, under these rules, in order to remain qualified, plans that are top-heavy must meet more rapid vesting schedules, provide a minimum benefit or a minimum contribution for all non-key employees, restrict the amount of compensation that may be taken into account by the plan in determining contributions or benefits and reduce the overall limits on contributions of benefits under an employer's defined contribution and defined benefit plan. The rules automatically apply where 60 percent or more of the benefits provided under the plan go to key employees who are defined as certain owners, officers and the highly paid. Since a disproportionately large share of top-heavy plans are small plans consisting of an owner and several common law employees, the rule leaves a small employer with a series of unpalatable choices. He may cut back his own benefits so that they are proportionately lower than the benefits of his employees, or he may bear cost of providing proportionately large benefits to this employees. If, as if often the case, neither choice is acceptable, the employer will have no viable alternative but to terminate the plan and cut off benefits to all employees.

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[5] Although the H.R. 10 plan rules contain limitations that appear similar, they did not evolve out of an effort to limit benefits to smaller employers, but rather, they evolved from a Congressional reticence (now generally accepted to be misplaced) to extend corporate tax benefits to the self-employed segment of the economy. See II, C, infra.

e. Cafeteria plans

On July 18, the President signed into law the Tax Reform Act of 1984 which contains new fringe benefit rules affecting cafeteria plans. Under these rules, not more than 25 percent of the total nontaxable benefits of the plan can be provided to employees who are key employees as defined in the section 416 top-heavy rules. If the 25 percent limitation is exceeded, key employees will be taxed as though they receive taxable benefits to the extent possible under the plan. Thus, under these new rules, many small business executives may not be able to participate in a cafeteria plan because there would be no way to avoid the 25 percent limitation. For example, in the situation where a plan consists of a key employee and two common law employees, and the benefits are distributed on an equal basis, the key employee will receive benefits that are in excess of the statutory 25 percent limit.

2. Inequitable application

The limiting provisions in all of these arrangements essentially reach only executives of small businesses. Whenever these executives receive more than a certain specified percentage of benefits under their plans, they are precluded from obtaining for themselves any of the tax-advantaged benefits of the established programs. This is the result whether or not there are other employees to be considered, or where, if judged under the traditional nondiscrimination rules, the benefit arrangement would be considered to have provided a fair percentage of benefits to common-law employees.

The special limiting provisions of Code §§ 120(c), 125(b), 129 and 416 should be viewed in contrast to the traditional nondiscrimination rules that apply uniformly regardless of the size of the business involved. For example, in order to satisfy the requirements of the traditional nondiscrimination standards of Code §§ 401 (qualified retirement plans), 79 (group term life insurance) and 105 (medical costs), contributions and benefits must be equally allocated on the basis of compensation to all employees in the covered group. As a general rule, provided every covered employee receives a percentage of benefits equivalent to his percentage share of total compensation, there is no discrimination. The special limiting rules in Code §§ 120(c), 125(b), 129 and 416 apply over and above these traditional nondiscrimination rules and create more stringent requirements that effectively deny benefits to executives of small firms.

AALU seeks uniform treatment for all employees across-the-board regardless of the size of the organization for which they work. If in a given set of circumstances, Congress feels it necessary to limit the economic group to which tax benefits are granted, there is ample precedent for doing it in an equitable fashion which does not discriminate against small business. Code § 415, for example, limits contributions to qualified plans by reference to a certain level of compensation that applies to all participants based on a flat percentage of salary or a set dollar limit regardless of the size of the business involved. One might take issue with the social policy on which section 415 is based, however, once that policy is accepted, section 415 goes on to generate a tax neutral rule as between large and small businesses. In a like way, the social security laws contain an across-the-board limit on the amount of compensation that will be considered for those purposes.

3. Need for neutrality

The tax laws should be tax-neutral respecting incentives for employment with large versus small business. To favor large business in the manner that has recently occurred severely hampers the ability of small business to develop and grow. Small businesses are typically service-oriented and are designed around the creative skills of a single individual or a small group of individuals. If the tax laws favor employment with large firms over small firms, talent will be drained away from existing small businesses and creative individuals will be discouraged from taking entrepreneurial steps to establish small businesses. Further, the lack of ability to retain qualified executives will encourage small businesses to be acquired by and merged with large businesses, thereby further diminishing the pool of small business talent in this country.

Real tax-neutrality would lead to special incentives for small businesses. Small businesses are at an automatic disadvantage compared to large businesses because of administrative costs, limitation of cash resources and other inherent problems. For example, it should be remembered that large corporations have opportunities, not available to small firms, to dispense to their employees tax-advantaged equity benefits such as stock-options. Real equality necessitates special incentives to offset these inherent disadvantages. Tax credits (limited to small businesses) for the set-up costs of fringe benefits programs for employees, for example, would reduce the initial costs that are particularly burdensome for small businesses.

AALU strongly urges Congress to recognize that there is a growing trend involving the denial of benefits to small business management level executives. The trend is both arbitrary and unfair and we recommend that Congress correct the course by imposing only those limits that are applied uniformly to all employees whether they work for a small firm or for the largest corporation.

B. Unnecessarily large administrative burden on small business

Major pension legislation has, in recent years, unfortunately, become too frequent, including, for example, the Retirement Equity Act of 1984, the Tax Reform Act of 1984, the Tax Equity and Fiscal Responsibility Act of 1982, the Economic Recovery Tax Act of 1981, the Multiemployer Pension Plan Amendments Act of 1980, the Revenue Act of 1978, and the Tax Reform Act of 1976. Following each of these legislative enactments, the Internal Revenue Service (Revenue Service) develops, over an extended period of time, temporary, proposed and final regulations that contained additional changes not clearly envisioned as part of the statutory structure. Further, the Revenue Service, in its administration of these laws, changes its interpretation through Revenue Rulings and other announcements that require further plan changes.

Plans are expected to be continually updated and submitted to the Revenue Service for approval of their qualified status under the tax laws. This has become a most difficult burden for employers and plan administrators. Yearly keeping up to date with regulatory changes is a substantial burden, but the added impact of the frequent legislative changes, especially the major changes included in this year's Retirement Equity and Tax Acts and TEFRA, have seriously exacerbated this problem. Coupled with this is the fact that most of the substantive employee benefit changes made by the Tax Reform Act of 1984 and TEFRA impact primarily on small business, a group that is less capable of accommodating these changes than are other segments of the business community.

The result is the creation of appreciable administrative burdens and an increase in operating cost for pension and profit sharing plans, especially those of small business. These cost increases arise not only from the substantive impact of the changes in the rules, but also from the administrative necessity of keeping the plans abreast of applicable legal requirements. Especially in the case of small plans, this burden may be very substantial indeed.

By and large, big businesses are better equipped to handle the complexity of the new laws than are small businesses. Large firms typically have their own specialized in-house staff familiar with employee benefits and have the resources to hire outside counsel for any additional expertise, as needed. Small firms, on the other hand, infrequencly retain in-house benefits experts and, due to their size, typically use outside consulting, accountant, actuarial, and legal firms for advice, which may cost more than retaining in-house expertise.

According to a recent study prepared for the Small Business Administration by James Bell and Associates, Inc. and ICF, Incorporated, per capita pension costs are substantially higher for small firms than for large. This study indicates that per capita costs declined from approximately $1,080 for firms with one to ten workers to $574 for establishments with 500 to 999 workers. Further the study shows that per capita pension administration costs, which are highest for very small firms (one to ten employees), decrease as firm size increases.[6]

The study also showed that about half of the small firms studied administer their plans themselves and about one-third use outside plan administrators and the remainder rely on insurance companies.[7] The study also documents that the ongoing administrative costs for small firms (under 100 employees) are an estimated $500 to $1500 per year (depending on the type of a plan and the number of participants).[8]

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[6] Coverage, Characteristics, Administration, and Costs of Pension and Health Care Benefits in Small Business, Final Report, submitted to the Office of Advocacy, Small Business Administration, by James Bell and Associates, Inc. and ICF Incorporated (March 1984).

[7] Id. page 75.

[8] Id. page 75.

With regard to the source of these costs, many small employers included in the study observed that it was not so much the regulations that were a burden, but rather the constant changes in laws and regulations which often impose substantial costs on the firms when they made plan amendments.[9] Among those areas of regulation and reporting requirements that were considered most burdensome by small employers were parts of the Form 5500, "Controlled Group Requirements", Percentage Coverage Requirements, some regulations under the Multiemployer Pension Plan Amendment Act, and "Merger and Spin-Off Rules".[10]

C. The need for full parity between corporate employers and the self-employed

One of the major beneficial aspects of TEFRA was a move to establish partial parity between corporate and noncorporate employers. Particularly in the treatment of qualified retirement plans, TEFRA largely eliminated the distinction that had existed between the two types of employers—a distinction which at this point is almost entirely one of form rather than of substance. To perpetuate it through the income tax laws does not serve to further any valid purpose. Instead, such a distinction merely adds unnecessary complication to the laws and encourages incorporation of businesses that would otherwise continue to operate in noncorporate form. The net result has been a proliferation of corporate entities motivated by the desire to utilize tax benefits available only to corporations when there is, in fact, no valid policy reason to treat corporate and noncorporate employers differently.

Because TEFRA has taken substantial steps towards full parity, Congress should now take the final step and complete the process. Congress should eliminate the other distinctions that exist in the law between corporate and noncorporate fringe benefits. Two of the most important of these are the treatment of group-term life insurance and the treatment of medical benefits for employees. Under the statutory rules of §§ 79 and 105, respectively, these benefits are only available through corporate form even though on policy grounds, self-employed individuals, as well as corporate employees, are equally entitled to the benefit of these rules.

Section 79 permits the exclusion of up to $50,000 of group-term life insurance purchased for an employee by a corporate employer. Where a self-employed individual purchases life insurance for himself, he does so with after-tax income and receives no deduction.

Section 105 generally provides that amounts received by an employee as reimbursements for medical care and payments for permanent injury or loss of bodily function are excludable from gross income. Under § 105(g), a self-employed individual is not treated as an employee for purposes of § 105. Therefore, for example, benefits paid under an employer's accident or health plan under § 105 to or on behalf of a self-employed individual will not be treated as received through accident and health insurance for purposes of the exclusions found in § 105.

Similarly, section 404(a)(8) limits the amount of contributions to qualified plans on behalf of self-employed individuals in a way that contributions on behalf of corporate employees are not limited. Section 404(a)(8)(C) permits a deduction for contributions only to the extent that such contributions do not exceed the earned income of the individual and to the extent that the contributions are not allocable to the purchase of life, accident, health, or other insurance. This provision tends, without a rational basis, to hamper the purchase of life, accident, health or other insurance through a qualified plan for self-employed individuals. Such a limitation does not apply to corporate employees.

AALU recommends that Congress promptly enact legislation eliminating all further distinctions in the tax laws in the employee benefit area between corporate and noncorporate business entities so that any benefits that are available for corporate employees should be equally available for self-employed individuals.

D. Manipulation of system by agencies charged with administering the tax laws

Congress frequently leaves to the Revenue Service responsibility for carrying out the laws through the promulgation of regulations. In some instances, the Revenue Service and the Treasury Department have used the issuance (or nonissuance) of regulations as a way to promote their own policy objectives whether or not those objectives reflect Congressionally propounded policy. A notable and recent example involves the 6-year delay in the issuance of the proposed cafeteria plan regulations under § 125. In the six years since the enactment of the section in 1978, numerous corporations had adopted cafeteria plans based on a reasonable interpretation of the statute and its legislative history. When the Revenue Service finally issued a news release and proposed regulations earlier this year, it took a very restrictive approach to what would be permissible under § 125. To add insult to injury the Revenue Service also proposed to apply these regulations retroactively even though it was well aware that the practices it proposed to prohibit had been employed in a large number of cases. The employment of those practices were not only arguably permitted under the statute, but were in fact encouraged by the government's failure to issue regulations during the six year period. In effect, the lack of action by the Treasury and the Revenue Service had the effect of enticing taxpayers into activity which those same agencies subsequently and retroactively said was impermissible.

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[9] Id. page 76.

[10] Id. page 76.

AALU believes that an agency should not be permitted to use the issuance or nonissuance of regulations as a way to promote policies that have not been enacted by Congress. Congress can avoid this problem in the future, by requiring the issuance of regulations within a reasonably short period of time after enactment of any new provisions affecting employee benefits. Failure to issue those regulations within the allotted time should preclude the issuing government agency from applying them with retroactive effect.

E. Section 79 nondiscriminatory life insurance exemption should be raised to $100,000

Section 79 provides that the cost of up to $50,000 of group-term life insurance paid by an employer shall be excluded from the income of the employee. Section 79 was enacted in 1964 and the $50,000 limit has not been changed since that date. AALU respectfully submits that the amount should be adjusted to reflect increases in the cost of living.

The legislative history of § 79 reveals that in setting the $50,000 limit, Congress considered whether the dollar amount was adequate to keep a family unit together when a breadwinner dies prematurely.[11] The House of Representatives had initially set the limit at $30,000 but the Senate, indicating its concurrence with the policy to protect family units, adopted a higher limit, $70,000. (In conference, the conferees settled on $50,000 without further explanation.)

In 1964, the dollar had the purchasing power of $1.08 (compared to the value of the dollar in 1967). In May, 1983, that same dollar had a purchasing power of only 34¢.[12] In other words, in the nineteen years from the enactment of section 79, the purchasing power of a dollar has dropped by more than two-thirds and the value of the $50,000 limit today is the equivalent of only $15,741. In order to restore the limit to its original purchasing power and to carry out the Congressional intent to permit the exclusion of an amount paid to purchase a sufficient amount of insurance to keep the family together at the time it loses its breadwinner, the $50,000 limit would have to be increased to $158,821.

The $50,000 limit in § 79 is grossly out of date because it has never been changed to reflect current economic realities. AALU is not suggesting that Congress apply automatic cost of living increases over which Congress has no control once enacted. Rather, AALU recommends that Congress increase the limit by setting an amount, perhaps $100,000, that takes into consideration the loss in the dollar's purchasing power since 1964. AALU suggests that the new limit be at least $100,000.

STATEMENT OF DWAINE H. SMITH, SENIOR VICE PRESIDENT, EMPLOYEE RELATIONS, ATLANTIC RICHFIELD CO.

My name is Dwaine Smith and I am Senior Vice President, Employee Relations, of Atlantic Richfield Company. My Company is a diversified resource company and is among the twelve largest industrial corporations in the United States. It sponsors a comprehensive package of employee benefits that provides a "safety net" of protection against economic hazards to employees. Most of the employee benefit plans that are offered are made possible only because of enabling provisions in the Internal Revenue Code. These tax favored provisions allow employees, particularly lower and middle income employees, to build upon the basic level of protection afforded by

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[11] Revenue Act of 1964, House Report No. 749, 88th Cong., 2d sess. 39–40 and S. Rep. No. 830, 88th Cong., 2d sess. 45–46.

[12] Statistical Abstract of the United States 1984, U.S. Department of Commerce, Bureau of the Census, p. 484.

Social Security and Medicare. We believe very strongly that tax preferences for welfare benefit plans and pension plans are critical in achieving broad employee participation in these programs. Our experience with the implementation of a Section 401(k) CODA Plan provides ample evidence that employee participation significantly increases with increased tax benefits. The abolition of these preferences will very likely cause employees to elect significantly reduced coverages, especially for those employees at lower income levels. In addition, since defined benefit and defined contribution plans constitute the major source of savings for middle and lower income employees, the restriction or elimination of tax preferences for these plans will have a significantly detrimental effect on the already low rate of personal savings. Because we believe that employee benefits serve useful social needs, I am submitting for the record Atlantic Richfield Company's position on tax policy and its effect on employee benefits. The submission focuses on my Company only and is structured as follows:

(1) Level of Tax Exempt Tax Deferred Employee Benefits; (2) Cap on Tax Favored Benefits; (3) Treatment of Tax Deferred vs. Tax Exempt Benefits; (4) Relationship Between Private Pensions, Social Security and IRA's; (5) Private Health Care Plans and Medicare; (6) Tax Treatment of Fringe Benefits; (7) Income Level of Employees Who Utilize Benefits; (8) Effect on Employee Benefits if "Tax Reform" Proposals Adopted; and (9) Maintaining a Viable FICA Tax Base.

APPROPRIATE LEVEL OF TAX EXEMPT/TAX DEFERRED EMPLOYEE BENEFITS

Our tax deferred benefits are paid from the Atlantic Richfield Retirement Plan (ARRP), the Savings Plan, a Capital Accumulation Plan (CAP), and a payroll based Stock Ownership Plan. The tax-exempt benefits are paid primarily from the Medical Plan, the Dental Plan, the Life Insurance Plan (up to the IRC. Sec. 79 maximum), and partially, from the Long Term Disability Plan. In addition, employees have the option, like other taxpayers, to open personal IRAs. Thus, employees are given ample opportunity to accumulate, on a tax favored basis, savings for both short term and long term needs. Given the combination of large federal deficits, and the fact that IRA deposits result largely from a shift of other savings rather than net new savings, Congress may want to re-examine the tax favored status of IRAs for those individuals also covered by employer sponsored plans. As for tax-exempt benefits, we submit that the majority of employers are already deeply concerned about increasing employee benefit costs, particularly health care costs, and are taking steps to contain these costs. For example, Atlantic Richfield Company has done the following:

(i) Taken a very conservative position on the creation of new employee benefit programs.

(ii) Designed our Capital Accumulation Program with an economic incentive for employees to participate, causing the generation of significant long term personal savings to be available only at termination or retirement. Over time, this will allow the Company to phase out our supplementary retirement program. (This plan grants periodic ad hoc retirement supplements to compensate retirees for the erosion of retirement income due to inflation.)

(iii) Redesigned our medical plan to contain the rate of increase in health care costs. Specifically:

Employees have been given a choice between an older, established "first dollar" plan or a newly adopted (1984) comprehensive plan that requires a greater amount of cost sharing on the part of the employee. The former costs the employee substantially more in monthly contributions, while the latter requires plan users to assume a greater share of the costs.

Employees are offered a selection of Health Maintenance Organizations (HMOs) in a more liberal manner than required by law.

The Company is active in employer coalitions in Los Angeles, Philadelphia and Houston. A Company executive chaired the Los Angeles Coalition in 1981-1982.

We have initiated a pilot program of utilization review in California.

We have implemented, and are refining a sophisticated claims data base system that pinpoints areas of over-utilization.

CAP ON TAX FAVORED BENEFITS

A tax cap could be either a percentage of compensation or a dollar limit. The obvious problem with any cap is to determine its appropriate level. If the cap is denominated in dollars, there is the immediate disparity accorded identical groups of employees situated in different areas of the country. Furthermore, in inflationary times, the dollar limit may not be increased in a timely fashion to reflect adequately the increased price level. The problem with a percentage of compensation cap is its very arbitrariness—lower paid employees may not be able to gain the maximum coverage of fixed cost benefits, while higher paid employees may often obtain the benefit and still have an excess available. In addition, those employers with older more highly compensated workers could be competitively disadvantaged as compared to employers with younger workers. If Congress feels caps are the best alternative, our preference would be for a percentage of compensation set at a level between thirty and forty percent, excluding legally required employer contributions from the base subject to the cap.

TREATMENT OF TAX DEFERRED VS. TAX EXEMPT BENEFITS

Employee benefits occupy a unique tax favored status in the Internal Revenue Code. Employer contributions to a qualified plans are deductible to the employer, earnings thereon are tax exempt, and there is no concurrent recognition as income by employees. When subsequently distributed, these monies often enjoy tax favored treatment such as ten year forward averaging and capital gains, or further deferral because of the rollover provisions in the Code. Perhaps Congress should study this area comprehensively and examine the integration of personal savings with the Social Security benefit. The significant increases in personal savings generated by IRAs and Sec. 401(k) plans should reduce future pressure on the Social Security system. Any decision to limit these plans, should not be taken lightly. The treatment of tax exempt benefits is a little more complex. Employer provided health insurance indirectly provides a form of living expense to employees in a tax subsidized manner. The same can be said for the provision of child care expenses. Both of these benefits, however, probably produce significant social benefit. Tax subsidized child care makes it easier for larger numbers of individuals to be wage earners and taxpayers. Tax benefited health insurance maintains medical coverage at a significantly higher level than would be the case if individually purchased and provides the majority of Americans with the best health case in the world. Moreover, tinkering with the tax favored status of this employee benefit may have the unintended effect of reducing care and increasing the incidence, severity, and impact of disease, especially for the lower paid segments of the population. Exhibit I attached shows the percentage of compensation that the Company's contributions to the Atlantic Richfield Medical Plan represent. A review of this exhibit shows that taxing such contributions will be highly regressive for the lower paid employees. It appears therefore, that in the areas of tax exempt benefits, the best approach might well be to continue the present statutory treatment of existing employee benefits, and restrict the creation of new benefits.

RELATIONSHIP BETWEEN PRIVATE PENSIONS, SOCIAL SECURITY, AND IRA'S

Much has been written about the three legged stool of retirement income security provided by Social Security, private pensions, and individual savings. We present in Exhibit II certain statistics relating to pre-retirement income replacement ratios of our employees. (Missing from these statistics is the component attributable to individual savings.) You will note that our retirement plan benefit combined with Social Security provides lower income employees with a proportionately higher wage replacement ratio than higher income employees. Our goal is to provide our employees with a post-retirement income that will afford them a standard of living approximating their pre-retirement standard. There is, however, an inconsistency in the taxation of this benefit. If the retirement benefit form the ARRP is taken as a lump sum benefit it receives favorable tax treatment. In addition, the presence of favorable taxation of lump sum benefits put pressure on employers to provide this form of payout even if society interests might be better served by payouts spread over retirement yeas and taxed as ordinary income. As previously indicated, the integration of these plans with Social Security and their tax status on payout merits further examination.

RELATIONSHIP BETWEEN PRIVATE HEALTH CARE PLANS AND MEDICARE

Our Company's philosophy in designing health care plans is to provide a reasonable level of protection to our active employees and retied employees not eligible for Medicare, in as cost-efficient a manner as possible. We believe that by keeping employees healthy, the effect is to reduce long term demands and costs associated with the medical care system. Retired employees eligible for Medicare are provided a level of protection that supplements the Medicare coverage. The partnership between private health care plans and Medicare can and should be strengthened. As the largest single purchaser of health care services in the country, Medicare has a very important role to play in helping the private sector provide appropriate health care services in a cost efficient manner. It can contribute to this area by careful screening of new medical technology before permitting Medicare reimbursement for the use of such technology. In addition, Medicare should frequently review surgical fee schedules and reduce high reimbursement levels for procedures that, while innovative when first performed, are now routine but continue to be reimbursed as if they were performed by only a few highly skilled professionals.

TAX TREATMENT OF CERTAIN FRINGE BENEFITS

Over the years, Congress enacted provisions in the Internal Revenue Code favoring specific employer sponsored retirement, health care plans and certain other statutory benefits, based on the premise that extensive coverage of workers and dependents under these plans is desirable social policy. These programs are a supplement to public programs and lessen pressure for increased Governmental involvement in such programs, which we believe generally deliver benefits less cost-effectively than private sector programs. These programs should continue to enjoy tax favored status. In recent years, however, certain tax advantaged benefits have been provided that do not meet a defined social objective (e.g. group legal plans.) We do not believe that this is an appropriate use of the Tax Code for social policy. It may now be appropriate to impose a freeze on the creation of new tax favored benefits. Alternatively, these programs could be removed from tax favored status or a cap set at a very low level could apply to such programs.

INCOME LEVELS OF EMPLOYEES WHO UTILIZE BENEFITS

Our Company designs our benefit programs to provide financial protection and individual and family security (alleviating problems which could reduce employees' productivity) for most of our employees. We attached a series of exhibits to this submission that show the income distribution of the participants in our employee benefit plans. It is obvious that the great bulk of benefits go to rank and file employees. The attached exhibits are: Exhibit I, Medical Plan; Exhibit II, Retirement Program; Exhibit III, Long Term Disability Plan; Exhibit IV, Death Benefit Plan; and Exhibit V, General Description of ARCO's Employee Benefit Plans.

EFFECT ON EMPLOYEE BENEFITS IF VARIOUS "TAX REFORM" PROPOSALS ARE ADOPTED

Tax Reform measures generally call for including employer contributions for employee benefits in the employee's adjusted gross income or eliminating employer deductions for such contributions. In the first case, severe problems would arise in implementation.

Group plans are designed without allocating costs on the characteristics of the individual employee. However, if individual employees are made to pay taxes on contributions made on their behalf, then the pricing and cost allocation structure of group plans would have to be altered drastically so as to allocate an equitable "taxable/economic" value to the benefit provided the individual. In the health care area, older individuals and young women of child-bearing age would be faced with high allocations of cost to be included in their income. As we show in the attached exhibits, Company contributions represent a higher percentage of compensation for low to moderate income employees than for higher income employees. It is therefore questionable whether these individuals will purchase comparable health care coverage in the absence of tax favored group plans. Furthermore, since health care "premiums" are derived without regard to employees' compensation, the flatter tax rates will mean that the tax treatment for lower income employees will be highly regressive.

Defined benefit program costs are determined on aggregate bases based on demographics and investment experience. Few plans calculate costs and allocate contributions on an individual basis. However, if contributions were allocated among individuals, then clearly the older employee would face a substantial increase in imputed income. In the case of our retirement plan which has a final three year salary average formula, the cost for a sixty year old employee could be twelve times that of a thirty year old employee. Whether this would result in employees declining coverage cannot be predicted.

If, on the other hand, deductions for employer contributions to employee benefit plans are eliminated, the effects would be different in that many companies might well decide to scale back or eliminate employee benefit plans.

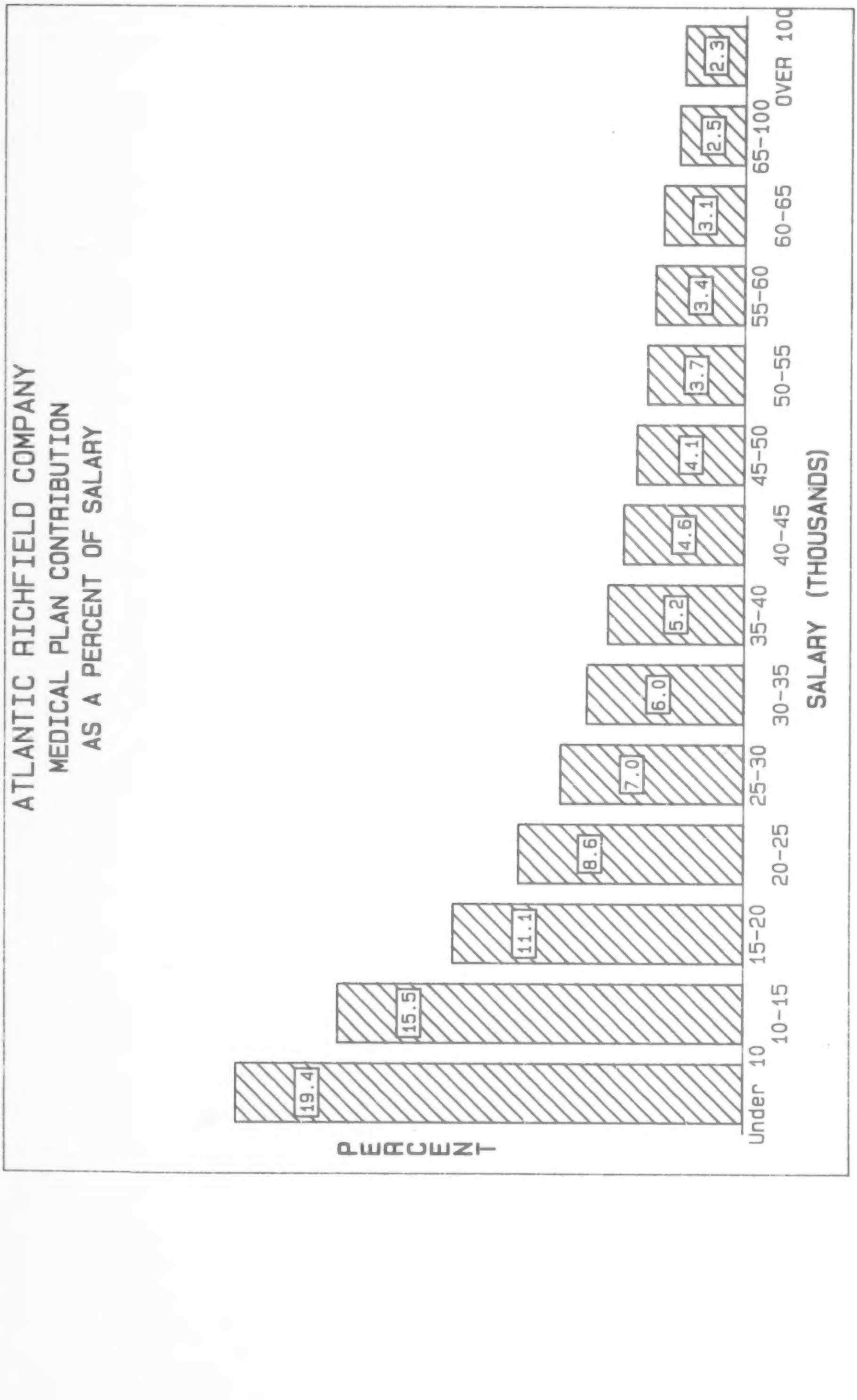
MAINTAINING A VIABLE FICA, TAX BASE

In order to maintain the viability of the FICA tax base, Congress can increase the number of participants in the system by:

Adopting policies that will increase the aggregate level of covered employment in the economy.

Including in the FICA program those classes of workers who are currently excluded. Expanding the level of coverage is one way to maintain the strength of the FICA system. Another way is to preclude the further erosion of the tax base by adopting measures, such as Congress took when it required 401(k) salary deferrals to be subject to FICA taxes.

EXHIBIT I


ATLANTIC RICHFIELD COMPANY
MEDICAL PLAN CONTRIBUTION
AS A PERCENT OF SALARY
PERCENT
19.4
15.5
11.1
8.6
7.0
6.0
5.2
4.6
4.1
3.7
3.4
3.1
2.5
2.3
Under 10
10-15
15-20
20-25
25-30
30-35
35-40
40-45
45-50
50-55
55-60
60-65
65-100
OVER 100
SALARY (THOUSANDS)

[Exhibit II]

RETIREMENT PROGRAM

The Company sponsors a number of defined benefit and defined contribution plans. The former are designed to replace, in conjunction, with Social Security, a significant percentage of employees pre-retirement income. The latter are primarily Capital Accumulation Plans, except for the Sec. 401(k) plan which is designed to provide retirement income supplements. Our experience shows that moderate income employees are not inclined to save on their own, an experience similar to other such employees across the nation. Accordingly, we designed a Saving Plan that is linked to the Sec. 401(k) plan, whereby employees cannot get the benefits of the Company's matching contribution to the Savings plan unless they also contribute to the Sec. 401(k) plan. This approach is apparently successful, as almost 90% of eligible employees participate in the Savings program. In addition, the Company has a supplemental retirement program that replaces a portion of retirees income that has been lost due to inflation.

Attached are examples of replacement rations for the Atlantic Richfield Retirement Plan (ARRP), which is the largest defined benefit plan in the Atlantic Richfield controlled group. It should be noted that the benefit formula is such that low to middle income employees benefit proportionately more than high income employees.

[Exhibit II(a)]

ATLANTIC RICHFIELD RETIREMENT PLAN PRE-TAX AND POST-TAX REPLACEMENT RATIOS, JAN. 1, 1984, RETIREMENT DATE WITH 30 YEARS OF SERVICE

Final pay	AFC [1] 8.5 percent salary assumption	Estimated Federal and local taxes	Preretirement disposable income	Social Security benefit	ARRP benefit	Total benefit	Pretax benefit as a percent of final pay	Post-retirement estimated Federal and local taxes	Total post-tax retirement income	Total post-tax of preretirement disposable
					MARRIED					
$25,000	$23,092.62	$5,572.27	$19,427.73	$13,140	$9,246.44	$22,386.44	$89.559	$253.89	$22,132.56	$113.92
50,000	46,185.24	15,699.84	34,300.16	13,212	19,638.12	32,850.12	65.70	2,103.87	30,746.25	89.64
70,000	64,659.33	25,568.64	44,431.36	13,212	27,951.46	41,163.46	58.80	4,684.21	36,479.26	82.10
100,000	92,370.48	41,895.00	58,105.00	13,212	40,421.48	53,633.48	53.63	11,071.34	42,562.14	73.25
150,000	138,555.71	72,207.20	77,792.80	13,212	61,204.84	74,416.84	49.61	20,960.69	53,456.15	68.72
					SINGLE					
$25,000	$23,092.62	$6,994.60	$18,005.40	$8,760	$9,246.44	$18,006.44	$72.03	$808.71	$17,197.74	$95.51
50,000	46,185.24	19,395.36	30,604.64	8,808	19,638.12	28,446.12	56.89	3,259.71	25,186.41	82.30
70,000	64,659.33	30,632.85	39,367.15	8,808	27,951.46	36,759.46	52.51	7,792.32	28,967.14	73.58
100,000	92,370.48	49,039.85	50,960.15	8,808	40,421.48	49,229.48	49.23	13,594.63	35,634.85	69.93
150,000	138,555.71	80,541.15	69,458.85	8,808	61,204.84	70,012.84	46.68	25,129.05	44,883.79	64.62

[1] AFC: Average final compensation; that is, average of the last 3 years salary figures assuming 8.5 percent annual increase in compensation.

EXHIBIT II(b)

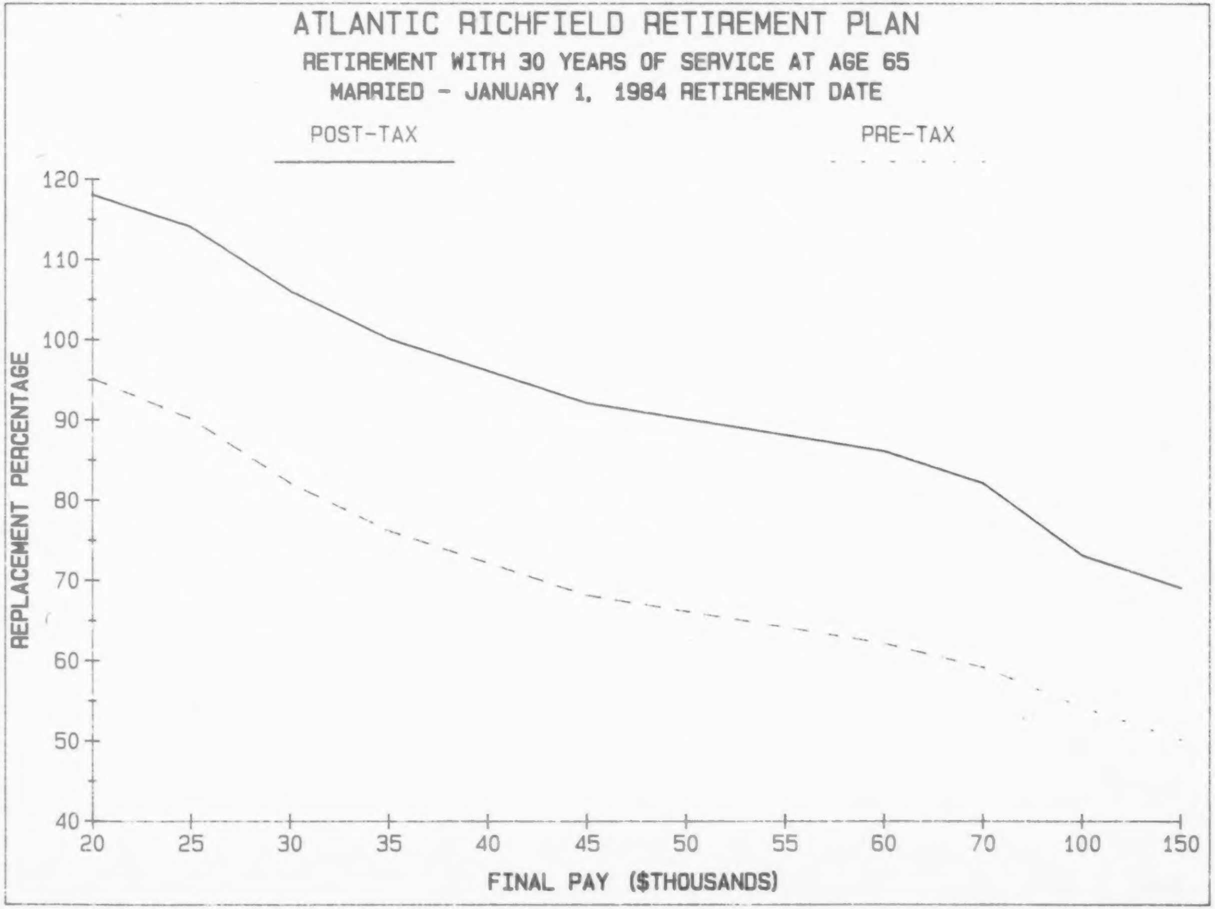
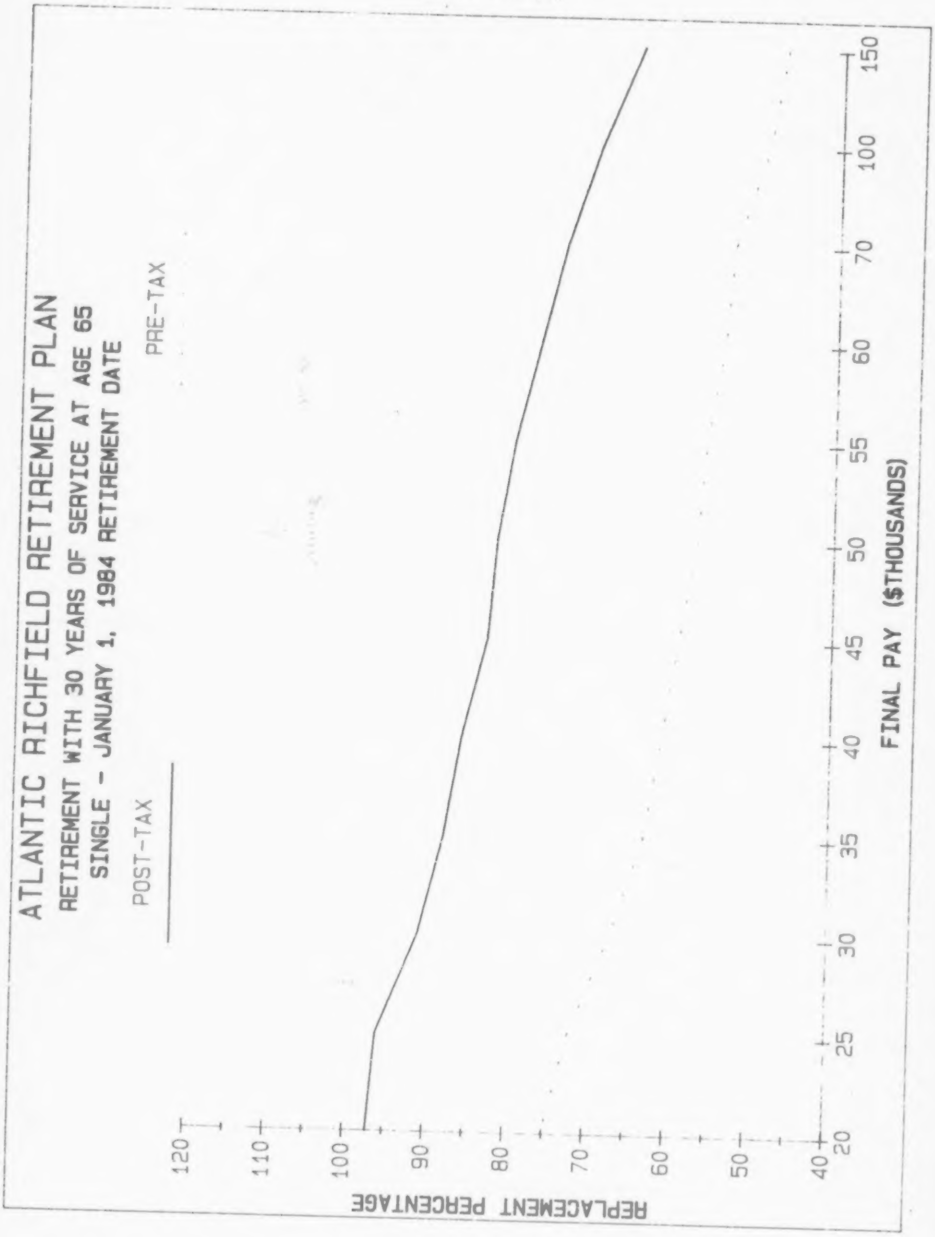

ATLANTIC RICHFIELD RETIREMENT PLAN
RETIREMENT WITH 30 YEARS OF SERVICE AT AGE 65
MARRIED - JANUARY 1, 1984 RETIREMENT DATE
POST-TAX
PRE-TAX
REPLACEMENT PERCENTAGE
120
110
100
90
80
70
60
50
40
20
25
30
35
40
45
50
55
60
70
100
150
FINAL PAY ($THOUSANDS)

EXHIBIT II (c)


ATLANTIC RICHFIELD RETIREMENT PLAN
RETIREMENT WITH 30 YEARS OF SERVICE AT AGE 65
SINGLE - JANUARY 1, 1984 RETIREMENT DATE
POST-TAX
PRE-TAX
REPLACEMENT PERCENTAGE
120
110
100
90
80
70
60
50
40
20
25
30
35
40
45
50
55
60
70
100
150
FINAL PAY ($THOUSANDS)

[Exhibit III]

LONG TERM DISABILITY

Atlantic Richfield designed the long-term disability program to replace a portion of income lost when an employee becomes permanently and totally disabled. In addition to receiving monthly payments from the Long Term Disability (LTD) plan, disabled employees continue their medical coverage on the same terms as when they were actively employed.

The attached graph shows that 91 percent of those receiving benefits are those employees who at the time of their disablement were earning less than $40,000. Note that under the terms of the plan, active employees earning more than $40,000 must contribute towards the cost of the plan. In return, their benefits from the plan are higher.

[Exhibit III(a)]

ARCO LTD REPLACEMENT RATIOS BY SALARY

Final salary	Average replacement ratio (percent)			Number of LTD cases
	Ratio of LTD plus retirement benefit	Social Security only	Total	
Under $10,000	35.8	20.9	56.7	6
$10,000 to $15,000	34.7	17.5	52.2	30
$15,000 to $20,000	35.3	22.6	57.9	104
$20,000 to $25,000	34.6	18.9	53.5	109
$25,000 to $30,000	33.9	15.9	49.8	83
$30,000 to $35,000	42.1	11.1	53.2	27
$35,000 to $40,000	37.4	11.2	48.6	14
$40,000 to $45,000	49.0	6.2	55.2	10
$45,000 to $50,000	53.9	7.0	60.9	8
$50,000 to $55,000	58.4	2.9	61.3	5
$55,000 to $60,000	56.6	7.5	64.1	6
$60,000 to $65,000	55.5	5.8	61.3	4
$65,000 to $70,000	0	0	0	0
$70,000 to $75,000	50.5	7.5	58.0	3
$75,000 to $80,000	0	0	0	0
$80,000 to $85,000	60.0	0	60.0	1
$85,000 to $90,000	0	0	0	0
$90,000 and over	0	0	0	0
Total				409

[Exhibit IV]

DEATH BENEFITS

The Company generally provides active employees with life insurance protection equal to their annual salary. This is given to them at no cost. Additional amounts of life insurance can be purchased by employees at their option.

The table below shows that 64% of all settlements for the past two years were for those employees whose salary at death was $40,000 or less.

PERCENT OF ARCO DEATH CLAIMS UNDER OPTION A (ONE TIMES SALARY)

Final salary	Total number of death claims (all options)	Number of claims with option A	Percent
Under 10,000	0	0	0
$10,000 to $15,000	1	1	100.0
$15,000 to $20,000	7	5	71.4
$20,000 to $25,000	16	6	37.5
$25,000 to $30,000	30	6	20.0

PERCENT OF ARCO DEATH CLAIMS UNDER OPTION A (ONE TIMES SALARY)—Continued

Final salary	Total number of death claims (all options)	Number of claims with option A	Percent
$30,000 to $35,000	20	8	40.0
$35,000 to $40,000	7	2	28.6
$40,000 to $45,000	9	2	22.2
$45,000 to $50,000	7	3	42.9
$50,000 to $55,000	4	0	0
$55,000 to $60,000	8	0	0
$60,000 to $65,000	4	0	0
$65,000 to $70,000	6	0	0
$70,000 to $75,000	3	0	0
$75,000 to $80,000	1	0	0
$80,000 to $85,000	1	0	0
$85,000 to $90,000	0	0	0
$90,000 to $95,000	1	0	0
$95,000 to $100,000	0	0	0
$0ver100,000	2	0	0
Total	127	33	

[Exhibit V]

Plan name	Participant[1] count	Eligibility	Benefit
Atlantic Richfield retirement plan	43,000	Employees with 6 mo company service.	1.15 percent of final average salary (3 yr) up to Social Security tax base +1.5 of the excess.
Capital accumulation plan (CAP)	25,000	Immediate	1–10 percent salary deferral.
Savings plan	23,000	Employees with 6 mo. company service and elective deferral of at least 1 percent to CAP.	Company match of $2 for every $1 of employee saving to a maximum of 4 percent of salary.
PAYSOP	36,000	Immediate for all full-time employees.	½ percent of payroll.
Medical and dental	[2] 36,000	Immediate for all employees	Medical and dental expenses; requires cost sharing by employee.
Life/survivor income	36,000	Immediate for all employees	One times salary.
Short term disability	36,000	Immediate for all employees	Depends upon length of employment.
Long term disability	28,000	Immediate for all employees who are full time and under 69½.	Represented employees receive 50 percent of predisability salary. Others receive 60 percent, with required contributions for employees earning in excess of $40,000.

[1] Rounded to nearest thousand.

[2] Does not include approximately 40,000 dependents who are also covered.

STATEMENT OF THE BANKERS LIFE, DES MOINES, IA

We, The Bankers Life, are a collection of financial companies which, among other things, serves about 50,000 U.S. employer sponsored pension and welfare plans covering 2 million participants. We manage between $8–9 billion of pension assets for these plans and pay out $1½–2 billion dollars per year in benefit payments. We've been in the employee benefits business over 40 years.

We submit our comments on the strength of our nation's partnership between the public and private sectors in providing those so called fringe benefits which are aimed at the major financial hazards for an employee—retirement, disability, catastrophic medical expenses, and employee death where dependents survive. Replacing lost employee income is the primary theme of these programs.

First, a couple of facts about our plan for our own employees. We have over 5,000 employees in our welfare programs (medical, disability and life insurance). Three-fourths of our welfare plan participants earn less than $20,000 per year. And 97% earn less than $50,000 per year. In our pension plan, which covers about 4,000 people (the 1,000 difference is our under 25 year old employees) ⅔ of the participants earn less than $20,000 per year and 96% less than $50,000. (Tables are attached showing detail.)

Next some facts about our customers. For most, we don't have employee wage and salary data in our records. But for 3,700 defined benefit pension plans covering 174,000 workers, we do have wage data in our files and have analyzed it. Sixty-five percent of these participants earn less than $20,000 per year. And over 97% earn less than $50,000 per year. These plans average covering about 50 employees each and many are much smaller.

But are these rank and file workers vested? Yes to a great degree. Almost half these participants have some vesting, and of these vested people, 56% earn under $20,000 per year and 96% earn under $50,000 per year. Again a table is attached.

What about retirees? We're paying pensions to over 100,000 retirees who are averaging less than $2,000 in annual pension.

Why is this data useful to you? We keep hearing the Congress thinks these programs are mostly for the rich, and we want you to know that in our broad experience with the small and medium size employers in the U.S., their programs are overwhelmingly providing benefits for rank and file workers, for low income and middle income workers. Yes the high paid are in there also, but they are a tiny minority.

During this century, the federal government has built the Social Security, Medicare and Medicaid programs, and has maintained tax laws favorable to private sector development of similar programs. We see first hand in our day-to-day business the strength of this public/private partnership in helping the ordinary worker. Depending on how you measure it, we have perhaps 1-2% of the employee benefit plan market in the U.S. Our customers are dispersed throughout the U.S. in every kind of private business imaginable. Our customers are likely a cross sectional slice of much of employee benefits in the U.S.—primarily small and medium size firms, but with a good representation of the very large U.S. companies.

All of us together have built a mighty partnership to protect America's workers against major financial hazards. And we ask you to move cautiously in improving it that we avoid tipping the scales to start the employee benefits system on a downward path.

The Census Bureau projects our over age 65 population moving from about 12% of population today to almost 20% some 40 years hence. Even with a significant pushback of retirement age, we're going to need more than ever a strong public/private partnership on both retirement income and medical expenses for our retired workers. Private enterprise has built an effective and efficient supplement to public programs covering employee needs. These needs are there and must be met. The private system should not be dismantled in the name of tax revenue. If the private system doesn't meet these needs, government must—and we believe its cost will be much higher. We want to caution you that small businesses think it is fair for their rank and file workers to get a combination of public and private benefits in the same proportion to pay that key people do. But benefit plan rules have moved to where they are, in relation to pay, beginning to discriminate against the higher paid. And as growing numbers of decision makers in small businesses find their benefits held down by dollar limits, we have a concern about the impact—will this result in an expansion or contraction of the private system? We suspect the answer is obvious.

Small businesses are very cost conscious. Our customers have rapidly moved over recent years so that only a small fraction still provide first dollar medical coverage. The order of the day is deductibles and coinsurance. Small businesses also very much correlate their retirement programs with Social Security—so public and private retirement combined make for a good retirement, but avoid over-pensioning in relation to preretirement pay. As another indicator of cost concern, most small business welfare plans call for employee contributions to pay part of plan costs.

We ask you to think long range across the decades about how to keep the public/private partnership on employee benefits healthy—and steer away from appealing short-range actions which damage the long-range outlook. Reach for a stable, long range policy on a public/private partnership for employee benefits.

TABLE 1.—HEALTH BENEFIT AVAILABILITY, 1984

	Total plan		Insured part		HMO part	
	Amount	Percent	Amount	Percent	Amount	Percent
0 to $9,999	447	8.2	423	8.4	24	6.4
$10,000 to $19,999	3,627	66.7	3,364	66.5	263	70.1
$20,000 to $49,999	1,198	22.1	1,113	22.0	85	22.7
$50,000 to $99,999	138	2.5	135	2.7	3	.8
$100,000 or more	25	.5	25	.5	0	0
Total	5,435	100.0	5,060	100.0	375	100.0

TABLE 2.—RETIREMENT PROGRAM AVAILABILITY, 1983

	Defined benefit			
	Participate		Vested	
	Amount	Percent	Amount	Percent
0 to $9,999	189	4.8	25	1.4
$10,000 to $19,999	2,454	62.3	798	45.1
$20,000 to $49,999	1,133	28.8	794	44.9
$50,000 to $99,999	138	3.5	130	7.3
$100,000 or more	24	.6	23	1.3
Total	3,938	100.0	1,770	100.0

TABLE 3.—RETIREE BENEFITS

Benefit	Number of persons	Total distributions or cost	Year
Defined benefit plan retirees in pay status	289	$1,800,000	1983
Defined benefit plan retirees survivors in pay status	37	175,000	1983
Defined benefit plan survivors of employees who died before retirement	30	100,000	1983
Defined benefit plan vested separated	320	NA	1983
Retiree health [1]	283	260,000	1983
Retiree life:			
Premium	283	230,000	1983
RLR deposit	283	1,200,000	1983

[1] Includes: 227 retirees, 37 survivors of retirees, and 19 survivors of employees who died before retirement.

This data is for those 3,662 of our plan sponsor customers where The Bankers Life has wage and salary data in its records.

TABLE 4.—RETIREMENT PROGRAM AVAILABILITY, 1983

Annual salary	Defined benefit			
	Participate		Vested	
	Amount	Percent	Amount	Percent
0 to $9,999	27,508	15.8	9,093	10.9
$10,000 to $19,999	85,470	49.2	37,672	45.1
$20,000 to $49,999	56,221	32.3	33,095	39.6
$50,000 to $99,999	4,003	2.3	3,020	3.6
$100,000 or more	722	.4	635	.8
Total	173,924	100.0	83,515	100.0

STATEMENT OF ROY B. HOWARD, CLYDE V. MANNING, AND RANDY L. NEW, ON BEHALF OF BELLSOUTH CORP.

BellSouth Corporation ("BellSouth") greately appreciates the opportunity to comment on the questions discussed in the joint oversight hearings on the distribution and economics of employer provided fringe benefits held by the Subcommittee on Social Security and the Subcommittee on Select Revenue Measures on September 17-18, 1984.

As you may know, BellSouth, a Georgia Corporation, is one of the regional holding companies established as a result of the divestitute of American Telephone & Telegraph Corporation. Two of our subsidiaries, Southern Bell and South Central Bell, are corporations which provide local access telephone services to the American public in nine states: Georgia, Florida, Alabama, Mississippi, Tennessee, Kentucky, South Carolina, North Carolina and Louisiana. BellSouth and its eigthy percent or more owned subsidiaries employ 97,000 people of whom approximately 50% are female and 19% are minorities. In addition, 25,000 retired employees participate in some or all of our employee benefit plans. Seventy-one percent of our employees are covered by collective bargaining agreements. We understand that we would be rated by Fortune 500 as the twelfth largest corporation in the United States were a rating based on assets. Our economic viability and employment opportunities are important throughout the southeast. The Bell System, of which BellSouth used to be a part, historically encouraged employees to save for retirement. We have continued that tradition and appreciate federal tax incentives provided by Congress which have assisted our efforts.

A variety of employee benefits are provided to employees of the BellSouth controlled group of corporations, although not all of our corporations' employees participate in all plans. Among our benefit plans are two qualified defined benefit pension plans, two qualified thrift plans, a new qualified Section 401(k) thrift plan which we have adopted on a limited basis, an employee stock ownership plan, self-funded and insured medical benefit plans, self-funded short-term disability plans, a self-funded vision care plan, self-funded and employee-paid dental care plans, and several nonqualified deferred compensation and employee incentive award plans.

Union-eligible employees and the lower-paid two-thirds of all nonunion-eligible employees constitute 90% of our total employee population. All of our employees are eligible to participate in all of the plans adopted by their respective employing corporation on the same basis after satisfaction of minimal service and age requirements.

I. OVERVIEWS

We have attempted to answer those questions posed by the Subcommittees in your press release of August 29, 1984 in the order in which they were presented; however, three overviews seem appropriate. First, all of the benefit plans which BellSouth provides to its employees are at some point in time taxable to the employee except, of course, for our medical benefit plans. At most, the revenue loss which occurs as a result of affording favorable tax treatment to fringe benefits is a short-term revenue loss which in large part represents income tax deferral, not income tax avoidance. This short-term loss "purchases" the creation of a large capital reserve which is used to promote investment in the American economy. For example, in 1983, the Profit-Sharing Council of America estimated that profit-sharing trusts alone held over $75 billion in assets which were invested in the America economy. Pension assets totaled $881 billion in 1982. Effect of Tefra on Private Pension Plans: Hearings Before the Subcommittee on Savings, Pensions, and Investment Policy of the Committee on Finance, United States Senate, 98th Cong., 1st Sess. 98-172 (1983) (Statement of Walter Holan, President, Profit-Sharing Council of America); Will More Flexibility Lead to More Taxation?, Employee Benefit Plan Review, January 1984 at 20. To the extent that Congress decreases the tax advantages of any benefit plan which is funded in advance by the employer or employee, Congress decreases the employer's and the employee's incentive to save and the likelihood that employee benefit funds will continue to be useful sources of investment funds for the U.S. economy.

Second, BellSouth understands that Congress intends to reexamine all employee benefits which receive favorable tax treatment. Indeed, the Subcommittees' press release, Chairman Stark stated that "[i]t is time to examine on a comprehensive basis all benefits exempted from tax currently in the Code." While BellSouth does not oppose a comprehensive Congressional review of employer-provided fringe benefits, employers have suffered over the past two years through several statutory and regulatory changes in benefit rules, and an air of uncertainty has been created in the business community as a result. We encourage a comprehensive review of employer-provided fringe benefits if, Congress (1) designs a comprehensive, long-term federal tax policy and (2) implements that policy slowly and incrementally over several years. The latter condition is important because employers have relied upon current laws in making significant commitments to their employees in the benefits area. Large employers like BellSouth are unable to change corporate benefit policies quickly as we have been asked to do in the recent past because our administrative personnel and our employees must be educated on the new benefit rules and these rules then incorporated into agreements and documents. We need sufficient lead-time to make those changes which Congress determines are necessary, and we need information concerning Congress' long-term goals so that our incremental changes will not lead to a BellSouth benefit policy which is adverse to these goals.

Third, we realize that the Subcommittees are especially concerned with Social Security taxation of employer-provided fringe benefits. While we understand the Subcommittees' desire to broaden the Social Security tax base and to assure adequate financing for Social Security benefits, we ask that Congress remember that the benefit plans which BellSouth maintains assist lower-paid employees to the same extent as, if not more than, higher-paid employees. Subjecting these benefits to Social Security taxation will adversely affect only those employees whose taxable compensation otherwise falls below the Social Security wage base. The questions announced in the Subcommittees' press release demonstrate concern for the receipt of benefits by lower-paid employees, and taxation of benefits may undermine that principle. At least 89 percent of our employees earn less than the Social Security wage base, and the lower paid in this group, not our more highly-compensated employees, will be adversely effected by subjecting benefits to FICA or FUTA taxation.

II. PREVALENCE OF FRINGE BENEFITS; AVAILABILITY AND UTILIZATION OF BENEFIT PLANS; PROJECTED CHANGES

The Subcommittee's questions in this area appear directed to those experts who have access to economy-wide data on employee benefits programs. While we are unaware of the distribution of fringe benefits among the entire U.S. workforce, all of our tax-favored employee benefits are available to our employees on a nondiscriminatory basis. The vesting, participation, and benefit rules applicable to the chief executive officers of our corporations are the same as the rules applicable to the lowest-paid employees in those corporations. Our qualified retirement plans provide a benefit based upon a percentage of the employee's wage or salary; however, our medical plans provide the same potential benefit to all employees and the medical benefits are based on the cost of providing the treatment to our employee population. All of our regular, full-time employees are eligible to participate in all of our tax-favored employee benefit plans after short service requirements have been satisfied.

We anticipate two general changes in our benefit packages in the future. First, the amount of our employer contributions to benefit plans depends upon cost considerations and our balancing of the well-being of the employee and the well-being of BellSouth. The current rate of inflation in health care costs and the escalation in the costs of our health care benefit plans have a detrimental impact on the economic viability of the health care plans. We currently are searching for solutions to this increasing cost spiral, and anticipate some design changes to promote cost-consciousness by our employees.

Second, in view of the change in the workplace demographics (more women and two wage families) BellSouth hopes to promote employee choice and selection in its benefit plans so that employees can tailor their benefit choices to match their individual needs. For example, we were actively exploring the adoption of a cafeteria plan under Internal Revenue Code ("Code") Section 125 as a method of controlling health care costs and promoting employee choice and participation; however, the Proposed Regulations which were recently issued by the Internal Revenue Service ("Service") have decreased our enthusiasm for that concept. We recently have adopted a qualified salary reduction plan authorized by Code Section 401(k) so that a portion of our employee population can contribute towards their own retirement benefit. While no significant revamping of BellSouth's benefit package is planned at this time, we obviously will be influenced by costs considerations, by a desire to provide additional benefit flexibility to our employees in the future, and by the tax advantages of those benefits.

III. RECEIPT OF BENEFITS BY SALARY RANGE AND OCCUPATION

As noted, BellSouth encourages all employees to participate in our benefit plans (i) by imposing only minimal service and age requirements in our defined benefit plans, (ii) by imposing minimal service requirements in our defined contribution plans, and (iii) by providing benefits on a percent of pay basis, matching basis, or cost basis in our deferred benefit plans, savings plans, and medical plans respectively.

We believe Congress should evaluate carefully any proposal to alter the tax treatment of medical benefit plans because these plans especially benefit lower-paid employees at the time of greatest need. While medical plans receive perhaps the most favored tax treatment of all benefit plans, medical benefit plans also provide a benefit to employees regardless of income which prevents economically devastating expenses from falling on a totally random group of employees. Thus, employers should not be discouraged from providing medical care plans by the imposition of disadvantagous tax treatment on such plans or by requiring administratively costly compliance with statutes or regulations governing the tax deductibility of medical plan expenses. Similarly, employees should be encouraged to participate in employer plans through tax-free receipt of employer-provided medical benefits to the full extent of the employer's willingness to pay for such benefits. We are concerned about the possibility that an employee ever will decline employer-provided insurance protection because receipt of protection would result in income tax liability and subsequently incur the devastating expenses associated with a heart attack, cancer, or a similar disease. Presumably any tax owed as a result of an employee's receipt of employer-provided protection would be paid from the employee's regular salary. We fear that an employee's willingness to receive taxable medical plan protection would decrease as the employee's regular wage or salary decreased. For your information, one of our largest individual claims in 1983, totalling $492,150, was paid on behalf of an employee earning $27,300. Another employee earning $19,700 faced medical claims totalling $236,046. As well, 75% of our medical care benefit dollars under our self-insured program were paid on behalf of represented employees with the highest rate of pay being $28,860. In 1983, BellSouth has six medical benefit cases paying over $200,000 each, with total aggregate payments equalling $1,729,672, for six employees with approximate average incomes of $25,000.

IV. PROCEDURE USED TO DETERMINE THE COMPONENTS OF BELLSOUTH'S TOTAL COMPENSATION PACKAGE; THE EFFECT OF FAVORABLE TAX TREATMENT ON THE SELECTION OF FRINGE BENEFITS OVER CASH REMUNERATION; EFFECT OF IMPOSITION OF FICA TAX

The allocation of compensation between fring benefit plans and direct pay is a topic of collective bargaining for a majority of our employees. The union representatives who participate in the bargaining process are well aware of the tax consequences of each fringe benefit and are doubtlessly influenced in bargaining by tax considerations. For nonrepresented, management employees, BellSouth establishes a fring benefit package through studies of competitive industries and their compensation practices. One overriding principle which we follow, notwithstanding our competitors' positions, is that the employee's well-being is the joint responsibility of the individual, the corporation, and the government. Therefore, we design our total management compensation package to encourage employee savings and employee individual selection of benefits, given (i) the corporation's ability to contribute to the costs of benefit plans, (ii) the ability of the individual under the Code and applicable law to select an individually-tailored benefit program, and (iii) the existence of government tax advantages for certain benefits.

Given this decision making process, the fact that tax favored treatment of fringe benefits markedly affects benefit selection is not surprising; however, we believe there could be a misunderstanding of the true influence of the Code on our benefit planning. Large, publicly-owned employers such as BellSouth suffer from the perception that tax-favored benefit programs are merely disguised shareholder dividends or tax shelters for the wealthy—a perception which may suggest to Congress that favorable tax treatment of a benefit merely encourages the selection of a benefit for its tax advantages. Perhaps this perception arises in part from a failure to understand the economics of employee benefits in a large, unionized employer. If BellSouth receives a credit or advanced deduction for providing an employee benefit, the tax savings really do not ever inure to the benefit of our shareholders. Before the credit or deduction is received, we have made an irrevocable commitment to spend a sum of money to provide a benefit to our employees. A tax credit never exceeds our cost in providing a particular benefit. An advanced deduction for a benefit to be provided in the future only compensates BellSouth for a real current payment of an equal amount of money since our unions and our status as a publicly-traded employer prevent any money committed to a benefit from reverting to BellSouth or its shareholders. If a benefit is made taxable to the employee, in whole or in part, we generally will be pressured by our union and our employees either (i) to "gross-up" the employee's salary or wage to neutralize the tax effect on his or her gross income or (ii) to eliminate the benefit. For example, we "gross-up" most of our payments to all of our employees for their relocation expenses (i) because most of their expenses will be in excess of the Code Section 217 dollar limits on deductibility of moving expenses reimbursements and (ii) taxation of expenses in excess of those limits may block relocations and impair resultant operational efficiencies.

The proposal to impose FICA tax on specific benefits (that is, Section 125 plan benefits) which currently are not subject to the tax would not be vigorously opposed by BellSouth from a corporate standpoint; however, Congress should consider that the imposition of FICA tax will adversely effect lower-paid employees and that some additional administrative costs to BellSouth will accompany the change. As noted, the tax advantages of most fringe benefits insure to the benefit of the employee ot the employer. As the tax advantages of a particular benefit decrease, unions and unionized employers will resolve the benefits versus cash compensation issue differently than they currently do. We cannot advise the Subcommimttees of the exact point at which any particular benefit will be abandoned because of the combination of increased administrative costs to the employer and decreased tax advantages to the employee; however, at some point, abandonment becomes the only viable course of action.

V. EFFECTS OF UTILIZATION OF FRINGE BENEFITS; HORIZONTAL AND VERTICAL EQUITY ISSUES

We believe that three macroeconomic effects of the current tax treatment of fringe benefits are important to consider in any comprehensive review of fringe benefit taxation. First, as noted, the advance funding of fringe benefits and, in particular retirement benefits which is encouraged by the existence of tax-exempt trusts promotes savings in the economy, thereby creating needed sources of investment capital. Second, retirement benefits in particular are a complement for Social Security. Congress' ability to moderate the rate of increase in Social Security expenditures ultimately will be dependent upon the income security which the private retirement system provides to millions of Americans. Without the private retirement system "leg" of the oft-cited three-legged stool of retirement income security in America, pressure would increase on the federal government to assure that retired persons have adequate income security through tax incentives for personal savings or government funded programs. As a general proposition, BellSouth believes that tax incentives should be provided for those benefits which inherently would be provided by the federal government if they are not provided by the employer. These benefits include retirement, disability, medical and death-type benefits, the last of which the federal government would be called upon to replace by providing survivors' benefits.

Third, a final, important effect of the promotion by Congress of those tax-favored benefit plans whch require advanced funding is that Congress also has encouraged employers to be fiscally responsible in providing employee benefits. Advanced funding of retirement benefits such as medical and death benefits and advanced funding of nonretirement benefits promote fiscal responsibility by employers; yet a trend to decrease employers' abilities to fund benefits in advance is evident from the reduction in the Code Section 415 limits contained in the Tax Equity and Fiscal Responsibility Act of 1982 and the complex rules limiting advanced funding of welfare benefits contained in the Deficit Reduction Act of 1984.

Advanced funding is a fiscally responsible action by BellSouth in particular because current ratepayers and not future generations of ratepayers should pay the cost of employee benefits to current employees. Moreover, demographic trends which suggest that more retirees will be supported by fewer working employees in the future indicate the need for advanced funding since advanced funding offsets the slow but steady increase in our liability for future employee benefits which occurs each year. Finally, the real danger of the welfare benefit plan funding limitations mentioned above will appear when employers experience low-profit and no-profit years and, as a result, decrease those employee benefits which would have been unaffected had advanced funding been allowed to occur through favored tax treatment.

Tax-favored treatment of fringe benefits does affect the horizontal and vertical equity of the income tax system. We believe fringe benefit plans are perceived to be a tax subsidy to higher-paid employees, an incorrect assumption in the case of large corporate employers such as BellSouth. Indeed, lower-paid employees' receive a proportionately greater benefit from our medical care plans than higher-paid employee since the payment of medical claims for a lower-paid employee who suffers a heart attack, for example, represents a greater percentage of that employee's regular salary than our payment of similar expenses for an higer-paid employee. As explained, our medical plans do not discriminate between employees.

The Subcommittees also have asked about the allocation of the tax benefits of certain fringe benefit plans among employers or among employees throughout the American workforce. While we have no data upon which to base a comparison of the tax benefits we receive or our employees receive with the tax benefits received by other employers and their employees, we design our compensation package to assure that we remain competitive with other employers. To the extent that BellSouth takes advantage of tax-favored employee benefit plans to the same degree as other employers who compete for our specially trained employees, tax benefits are distributed more equally throughout the economy. Congress should consider that employers such as BellSouth must have a sophisticated, tax sensitive benefit package since we must attract and retain highly specialized, technical employees.

VI. EFFECT ON FICA RATES AND SOCIAL SECURITY WAGE BASE OF FRINGE BENEFIT PLANS

This series of questions as stated in the Subcommittees' press release requires information unavailable to BellSouth. However, if we can be of assistance to the Subcommittees or Congress in generating information of this type we gladly will assist you.

VII. EFFECT OF FIXED DOLLAR CAPS, EXCISE TAXES OR LIMITS ON PERCENT OF COMPENSATION ON BENEFIT PLANS

Individual limits already exist on most benefits which receive favorable tax treatment. For example, only the cost of the first $50,000 of employer-provided, group term life insurance is provided tax-free to the employee. I.R.C. § 79(a)(1). While current limits seem to us to balance adequately the need for tax revenues against Congress' desire to encourage employee benefits, we can envision even more percentage limitations, fixed dollar caps, and excise taxes. Congress should realize that the adoption of a fixed dollar cap above which benefits would be taxable or the adoption of an excise tax will effectively set the level at which a particular benefit will be provided by most employers. As explained, our benefit package in large part is negotiated with our employees and otherwise is governed by competitive pressures. As a general rule, we do not believe our represented employees would be as interested in receiving a benefit, including medical care insurance protection, which would be subject to full income taxation or to excise taxation. Moreover, to the extent that other employers responded to these effective limits on benefits prior to our benefit planning decision, the competitive pressure on us to provide a greater albeit taxable benefit would disappear.

If Congress adopts fixed dollar caps or exicse taxes which are applicable to specific benefits, we believe Congress should also consider adopting more liberal cafeteria plan rules than those stated in the Proposed Regulations recently promulgated by the Service. As a final note on the fixed dollar cap proposals and as an illustration of the principles we espoused in our overviews, if a cap on any benefit is adopted by Congress under the assumption by Congress that the dollar limit will be frozen or decreased in the future despite inflation in health care costs, that assumption should be communicated to employers in advance so that they will understand in designing their benefit plans Congress' long-range goals and so that they may begin to respond to these realities in a timely fashion.

VIII. RELATIONSHIP BETWEEN FRINGE BENEFITS AND GOVERNMENT-PROVIDED SOCIAL PROGAMS; COMPARISON OF EMPLOYER-PROVIDED BENEFITS WITH PUBLIC PROGRAMS

We realize that credits, current deductions, and exclusions for employee benefits are perceived to have short-range, negative net revenue effects. However, reliance on employers to provide fringe benefits has at least two positive, offsetting effects. First, benefits are delivered by employers more economically than by the federal government because (1) employers are in a better position to tailor benefit programs to specific employee needs, depending upon the ages, working conditions, socioeconomic status, and other characteristics of their employees, (2) the volume of business generated by a large employer of our size provides us with the purchasing power to buy benefits at the lowest possible cost, yet (3) as the number of persons who belong to a particular benefit plan grows smaller, each persons benefit costs affect benefit prices to a great degree, and each person becomes more sensitive to the need to avoid wasteful overutilization. The latter reason for favoring employer-provided benefits is important since employees too often fail to discern the cause-effect relationship between overuse and abuse of federally-funded benefit programs and their individual tax liability.

Second, if nothing else, providing tax incentives for employer-provided benefits saves the federal government the expense of administering federally-provided benefits. In providing employee benefits for approximately 122,000 people, BellSouth benefit planning and administrative costs, excluding pension trust fund management costs, on an estimated annualized basis for 1984 equal $17.1 million. Our pension fund administration costs are $10.5 million. While these costs are significant, the benefit administration costs are less than 2% of the total cost of benefits delivered to participants, and our treasurer's administration costs are less than .2% of the value of the trust fund. Our administrative costs are minimized as much as possible and the federal government's experience in providing replacement benefits probably would not be as favorable.

IX. SUMMARY

We appreciate the opportunity to express our views to the Subcommittees on the taxation of employer-provided fringe benefits. If you have specific proposals or questions, we would appreciate the opportunity to express our views again.

Statement of the Blue Cross & Blue Shield Association

The Blue Cross Shield Association, the national coordinating organization for the 96 Blue Cross Shield Plans, appreciates the opportunity to submit this statement. Today, Blue Cross and Blue Shield Plans provide health care coverage for more than 80 million Americans. Most of our subscribers maintain this coverage through group policies offered by their employers, although a substantial number—13 million—are covered under individual health benefits contracts.

The Committee has posed a number of questions concerning the availability and scope of fringe benefits. Based on our experience, we would like to comment on those that relate to the tax treatment of employer-provided health benefits and what would be the effect of changes in their tax status.

Current tax policy clearly establishes incentive for employers to provide certain employee benefits—particularly those that protect workers and their families against loss of income or high expenses due to retirement, disability, illness, and death. There are two major principles underlying this policy. The first is that assuring the economic security of active, disabled, and retired workers and their dependents is beneficial to society as a whole. The second is that government-operated programs alone cannot and should not be expected to achieve the goal of economic security for this population.

We believe these principles are as valid now as they were 30 years ago when the basic tax treatment of employee benefits was codified. In our view, the fundamental issue is not *whether* government should be involved in protecting workers and their families from loss of income or the high costs of illness but *how* the government should be involved. Government involvement can be through incentives in the tax code for the private sector to establish and operate benefit programs, or through the expansion of benefit programs operated directly by the government. We believe that the encouragement of private sector benefit programs is the better alternative. Therefore, we recommend that the current tax incentives for certain employee benefits be preserved.

TAX TREATMENT OF HEALTH BENEFITS

Current tax policy encourages the provision of health benefits through employment by not treating the costs an employer incurs to provide these benefits as taxable income to the employee. In addition, the employer does not pay payroll taxes—such as FICA and unemployment—on these costs. These tax policies have been a major factor in the growth of employment-related health coverage. Three quarters of the labor force have employment-related health coverage. This coverage provides protection for about 177 million employees and their dependents.

We believe that this country's extensive group health benefit coverage has had substantial value for workers, employers, health care providers, ghe government, and society as a whole. Workers, including those who could not afford to buy insurance, or who would otherwise fail to purchase it on their own, are protected from the unexpected and major costs of illness. Health benefits administered and financed through a group of employees are less expensive than if comparable insurance were purchased by individual workers. Moreover, the employer can serve a valuable role in the health insurance marketplace as a well-informed bargaining agent for his or her employees. Through this bargaining and negotiation, employers can tailor a unique health benefits program that meets the often diverse needs of workers and their families as well as the needs of retirees and their dependents. In addition, employers are able to attract and retain workers through the provision of health coverage and the inclusion of particular benefits. Finally, employee morale and productivity are enhanced as a result of increased job satisfaction, and this, in turn, strengthens our economy.

By encouraging private group health benefits, current tax policy also has positive effects on our health care delivery system. Providers of health care services, particularly hospitals, are assured of payment for their services. Because of this, insurers play major role in avoidance of hospital bad debts, adn that means a significantly smaller role for the federal and local governments in support of community hospitals.

Finally, and importantly, existing tax policy reduces the need for expanded government funded and administered entitlement programs.

Because group health coverage is a benefit which is critical to our nation's well-being and productivity, the present tax treatment of health benefits is particulary appropriate. Accordingly, the Blue Cross and Blue Shield Association strongly opposes the taxation of employer-provided health benefits.

We would now like to address briefly proposals to limit the current tax exclusion that applies to employer contributions to health benefits plans.

PROPOSAL FOR A TAX CAP ON EMPLOYEE HEALTH BENEFITS

The present Administration and some Members of Congress favor taxing the value of employer-provided health bemefots above certain levels—the so-called "tax cap." While, to some, a tax cap may seem to represent a convenient shortcut in dealing with the federal deficit or an effective way to control health care costs, in our opinion the adverse consequences for millions of Americans would be serious.

We believe that the adoption of this type of proposal would be both bad tax policy and bad health policy for the following reasons.

A tax cap would diminish the government's commitment to use tax incentives to have the private market provide protection against health care costs.—A major objective of our tax system is to encourage the private sector to undertake socially useful activities in order to minimize the need for tax-supported government programs. A tax cap on health benefits would send a signal that government had reduced its commitment to protecting the health of the work force and their families. Enactment of even a high level tax cap would be deceptive. Once in place, the temptation to "ratchet down" the cap each year—in search of new revenues—would prove irresistible.

A cap would impose a "sick tax" on older and cronically ill workers, and on their employers.—Different employee groups have different health care needs. Because older and chronically ill workers tend to use more health benefits, the cost of providing health benefits to a group in which these workers are heavily represented will be higher than the cost of health benefits for a group of young healthy workers. Consequently, if a cap were imposed on the amount of employer-provided benefits, or for that matter if all of the health benefits were taxed, employees of companies with a relatively high percentage of such workers would have to pay more taxes than workers of other companies.

A tax cap could also have other serious, although more indirect, adverse effects on older and chronically ill workers. If employers responded to the tax cap by offering employees a choice of plans—a low option which is non-taxable and a high option which is taxable, those who perceive themselves as healthier likely would choose the lower-cost, minimal coverage plan. Less healthy workers would want the protection of a more comprehensive, higher-cost plan. Over time, the cost of providing services to the high users would drive up the premium of that group and consequently the healthier workers would drop out. This "adverse selection" would put the cost of the more comprehensive protection out of reach for those who need it most.

While we do not have precise estimates of the financial effect of a tax cap on groups with "high risk" workers, Blue Cross and Blue Shield Association actuarial simulations suggest how the Administration's proposal might affect older workers. The additional taxable income for family coverage provided by a particular Blue

Cross and Blue Shield Plan (with a 75 percent employer contribution) is estimated to be 31 times higher for workers employed in older employee groups (average age 55–64) than in younger groups (average age 35–44). Under the Administration' proposal, this would mean taxable income of $1,306 versus $41.

A cap is not needed to contain health care costs.—Cost containment has recently emerged as the major factor in the delivery and financing of health care. Purchasers of health care, as well as providers have increased their level of sophistication in a very short time. Programs have been developed to reduce inpatient lengths of stay, to determine whether services such as diagnostic tests and surgery should be performed on an outpatient rather than on an inpatient basis, and to determine prior hospitalization whether a hospital admission is warranted. For example, by using hospital utilization review, Blue Cross of Iowa reduced small group premiums by a total of $24 million, and Blue Cross of Northeast Ohio reduced experience-rated group premiums by 4 to 6 percent.

Another approach being used to control costs is the offering to employees of financial incentives to use designated hospitals and physicians in the communtiy that, through a contract, will provide health care services for a lower price or with more stringent utilization controls. These new arrangements are called Preferred Provider Organizations—PPOs—and have demonstrated significant savings. For example, by using perferred providers arrangements, Blue Cross of California has cut premiums for large group accounts by an average of 13 percent, while Blue Cross and Blue Shield of Minnesota reduced rates by an average of 10 percent, saving $10 million. A variant on the PPO approach is called "selective contracting," in which an insurer or employer contracts with selected providers in the community whom they know provide high quality services at lower costs. Employees are not reimbursed for their medical expenses if they go to providers not covered under the contract. This also has resulted in lower health care costs for employers.

In addition, more and more employers also are offering their employees the option of a health maintenance organization—an HMO—since HMOs have strong financial incentives to control utilization of services while still providing high quality of care.

These approaches are helping to contain the cost of group health benefits. The Business Roundtable's Task Force on Health recently reported that, as a result of various steps taken by its members, average health care spending per recipient for the first quarter of 1984 increased only 8.4 percent from the first quarter of 1983 compared with 12.7 percent for the same period a year earlier.

A cap would be regressive taxation.—Data from the Congressional Budget Office and the Employee Benefit Research Institute show that, of those employees who would be subject to additional taxes, the financial burden would fall heaviest on those with the lowest incomes. For example, under the Administration's proposed cap, workers who earn less than $10,000 a year would pay an additional 2.8 percent of their income on average. Workers earning more than $50,000 a year would pay taxes equivalent to only 0.4 percent of their income. Reducing the benefit package to a value below the cap could result in dropping important benefits or providing for significantly greater employee cost-sharing. Furthermore, because lower-income persons are less able to pay, any new cost-sharing requirements or out-of-pocket costs for non-covered benefits also would affect them disproportionately.

For all these reasons, we believe that Congress should not tax employment-related health benefits.—Some might charge that the current tax status of employer-provided health benefits is inequitable because it applies only to health coverage obtained through employment. While it is true that health insurance premiums for those who must purchase individual coverage are paid for with after-tax dollars, the medical expense deduction has helped mitigate this expense. If Congress wishes to address the differences in tax treatment of employer-provided versus non-group health coverage, we suggest reconsideration of the 1982 change which raised the threshold for claiming the medical expense deduction from three percent to five percent of adjusted gross income, and eliminated the separate deduction for health insurance premiums up to $150. Restoring the separate premium allowance, in particular, would represent at least a partial solution to this problem.

SUMMARY

In conclusion, we want to emphasize the value of using tax policy to encourage the private sector to provide benefits which protect our citizens from economic insecurity. With respect to health benefits, we strongly recommend that Congress not impose a tax cap or other form of tax on employee health benefits. Such a tax is not needed and would hurt those most in need of health care.

Statement of Yung-Ping Chen, Ph.D.,* Bryn Mawr, PA

I appreciate the opportunity to submit a statement on the distributional effects of employer-provided fringe benefits, a topic that has not gained but merits attention. I also wish to commend the Subcommittee on Social Security and the Subcommittee on Select Revenue Measures for holding a hearing on fringe benefits, a subject with far-reaching implications for Social Security and individual income taxation, as well as for the role of workers employers and government in the provision of economic security and material well being for individuals and families.

The incidence of fringes is uneven among workers in different industries. Some are "fringe-rich" and others "fringe-poor."

According to a 1980 survey of 983 companies by the Chamber of Commerce of the United States, among the "high-fringed" industries were petroleum (the highest), primary metal, chemicals and allied products, public utilities, banks, finance companies, and trust companies. Among the "low-fringed" industries were textile products and apparel, wholesale and retail trade, and hospitals (the lowest).[1]

Chamber estimates for the economy as whole in 1980 also showed substantial industry-by-industry variations in fringe benefit levels. Utilities and communications, mining, finance (including insurance and real estate), transportation, and manufacturing were industries that paid fringe benefits higher than the national average, whereas trade (including wholesale and retail), construction, and services were industries with lower-than-national-average fringe benefits.[2] The annual average number of workers employed in these three low-fringed industries numbered almost 43 million, constituting more than than 57 percent of all employment in nonagricultural private-sector establishments. (See table 1.)

TABLE 1.—NUMBER OF WORKERS IN TRADITIONALLY LOW-FRINGE INDUSTRIES AND THE PROPORTION OF SUCH WORKERS IN THE TOTAL PRIVATE-SECTOR NONAGRICULTURAL EMPLOYMENT: ANNUAL AVERAGES FOR SELECTED YEARS, 1950–1980

[Amounts, other than percent, in thousands]

	1950	1960	1970	1980
Trade (Wholesale and retail)	9,386	11,391	15,040	20,573
Construction	2,364	2,926	3,588	4,469
Services	5,357	7,378	11,548	17,740
Total	17,107	21,695	30,176	42,782
Proportion of workers in low-fringe industries in total private-sector employment (in percentage):				
Trade (wholesale and retail)	24.0	24.9	25.8	27.6
Construction	6.0	6.4	6.2	6.0
Services	13.7	16.1	19.8	23.8
Total	43.7	47.4	51.8	57.4

Source: Calculated from data in table C–1 in Employment Training Report of the President, Washington: U.S. Government Printing Office, 1981, p. 211.

During the last three decades, the number of persons on payrolls of these three "low-fringed" industries increased substantially, from 17.1 million in 1950, to 21.7 million in 1960, 30.2 million in 1970, and 42.8 million in 1980. Moreover, in the same period, employment in these industries as a proportion of all private-sector nonagricultural employment also increased: from 43.7 percent in 1950 to 47.4 percent in 1960, 51.8 percent in 1970, and 57.4 percent in 1980.

Because it is levied only on cash wages, the FICA tax takes a larger percentage of these fringe-poor workers' compensation. Unless they increase their share of the growing total fringes, they will suffer an increasing relative disadvantage as compared with the fringe-rich

This relative disadvantage will occur despite an OASDI weighted-benefit formula which favors low earners, who are most likely fringe-poor. Even though the formula yields more OASDI payments to low earners relative to their FICA taxes, they received more OASDI payments long after they have paid their FICA taxes. Meanwhile, during the years in which they are working, they must pay for the protection out of their taxable cash wages. In contrast, the fringe-rich receive sizable current, as well as old-age benefits, either tax-free or tax-deferred.

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* The Frank M. Engle Professor in Economic Security Research, he concurrently serves as professor of economics and research director of the McCahan Foundation, The American College, Bryn Mawr, Pennsylania.

[1] Chamber of Commerce of the United States, *Employee Benefits 1980*, Washington 1981, p. 9.

[2] Op. cit., p. 2.

Thus, I urge that the distributional effects of fringe benefits on the fringe-rich versus the fringe-poor be seriously taken into account when considering legislation on fringe benefits.

STATEMENT OF HARTZEL Z. LEBED, EXECUTIVE VICE PRESIDENT, CIGNA CORP., AND PRESIDENT, CONNECTICUT GENERAL LIFE INSURANCE CO.

CIGNA Corporation, formed in 1982 through the merger of Connecticut General and INA, is the second largest stock insurance company in the United States, with over 45,000 employees worldwide, and nearly 40,000 employees in the United States. CIGNA's Employee Benefit and Financial Services Group provides life and health insurance products, pension and retirement savings products and investment vehicles, as well as related services to employers and individuals. We are the fifth largest commercial insurer in the medical coverage marketplace, second largest in dental insurance, and first in long-term disability coverage. We insure over 5 million employees and their dependents for medical coverage. We manage over $15 billion in pension assets, representing over 20,000 retirement plans that cover over 1 million individuals. My statement reflects CIGNA's views both as a major provider of employee benefits and as an employer sponsoring a complete program of benefits for its own employees.

We commend the Subcommittees' initiative in holding hearings to gather information on the important subject of fringe benefits and the tax policy issues that relate to them. The Tax Equity and Fiscal Responsibility Act and this year's Deficit Reduction Act made numerous and significant changes in the federal tax laws that affect employee benefits. These changes were made primarily because of revenue considerations, and, in many cases without sufficient understanding of the issues involved. Many members of Congress have indicated that proposals to reduce or further limit the favorable tax treatment of employee benefits will be seriously considered in the next Congress. These hearings are an important opportunity for constructive dialogue and education on the social and economic purposes for employee benefits, their distribution throughout the workforce and the true costs and value provided by these benefits. CIGNA believes there is a pressing need at this time to develop a comprehensive and cohesive long-term national policy on employee benefits. Therefore, we appreciate the opportunity to participate in the hearings.

This statement addresses four questions raised by the Subcommittee in the announcement for these hearings:

(1) What social purposes are served by employee benefits?

(2) Are employee benefits available and received by workers at all income levels?

(3) What is relationship between fringe benefits provided by employers and social programs provided by the government? If certain fringe benefits are not provided by employers, would there be an increased dependency on federally funded social programs?

(4) Which is the most efficient use of resources: encouraging employers to provide benefits through preferred tax treatment or direct provision through public programs?

SOCIAL VALUE OF EMPLOYEE BENEFITS

Employee benefits, although known for many years as "fringe benefits", have evolved into something much more than a peripheral component of employment. They now represent an important form of compensation, which helps employers attract and retain productive employees, offer valuable services in an economical and efficient manner, and meet important social needs for health and income protection and family security. Through changes in the economic environment, demographics and family structure, and changing perceptions of the role of government in preserving the social fabric of America, employee benefits have evolved as the most important single non-wage vehicle for the long-term economic security of workers and their families.

Access to health care, through adequate health insurance benefits, is an important and long-standing social goal of our nation. Health care is considered to be a vital necessity by the American public. In the minds of most people, it is not a question of whether benefits will be provided, but rather how and who will provide them. The widespread availability of private health insurance benefits removes a significant cause of economic uncertainty from an individual's future, ensuring greater worker productivity and overall well-being. The greatest single fear of the individual American is that of catastrophic medical expenses; a corresponding comfort is achieved when American workers know that their employers have established and maintain properly structured and cost effective health benefit programs.

Equally long-standing has been the national commitment to providing incentives for private pensions and capital accumulation plans. They are critical components in the three-legged stool of retirement income security—Social Security, private pensions and individual savings. In addition to concerns with health care, employees are concerned about adequate retirement income. These concerns drive much of their savings and investment behavior. As it is, we save too little as a nation, and individuals often wait too long before starting to save for retirement. We need greater encouragement for savings and investment, not less. The advance-funded private pension system provides needed long-term funds for capital formation. These are not insubstantial sums, and are particularly important given the influx of foreign investment in the U.S., which has begun to shift the balance of ownership of productive capacity from U.S. to foreign firms.

DISTRIBUTION OF EMPLOYEE BENEFITS

An appropriate goal of employee benefits tax policy is, and should continue to be, the broad distribution of benefits throughout the workforce. This goal is being achieved. Recent research findings complied by the Employee Benefit Research Institute (EBRI) indicate that benefits are widely distributed across all income levels throughout the workforce. In 1983, 76 percent of all workers covered by an employer pension plan under ERISA standards, and 78 percent of all workers covered by an employer group health plan with their employer, earned less than $25,000. These findings are detailed in EBRI's statement and we urge the Subcommittee to consider them carefully.

More specifically, at CIGNA benefits are available generally to all regular employees without distinction of age, sex, marital status, or salary. Virtually all CIGNA employees enroll for the medical insurance plan or an HMO and share in the cost of these benefits. The CIGNA pension plan automatically includes all employees, including temporary employees. We also provide a matched savings plan in which all permanent and temporary employees are eligible to participate after one year of service.

To be sure, the current system of employer-provided benefits could be further improved. In the pension area, for example, there are gaps in coverage, particularly in certain industries and among mobile employees. We believe broader pension coverage should be encouraged by providing incentives specifically targeted to these problem areas. Similarly, where abusive situations are identified, they should be eliminated through carefully targeted measures, either legislative or administrative. But I do emphasize again that the privately provided employee benefits system is generally working well, and as Congress intended. Specific problems should be addressed by specific solutions.

With respect to pension benefits particularly, it is also important to note that the private pension system is still maturing. The importance of private pensions as a source of retirement income will increase significantly in the future. Research sponsored by the American Council of Life Insurance (ACLI) and conducted by ICF, Inc. indicates that benefit receipt at age 67 for the group aged 35–44 in 1979 will be 25 percent higher than benefit receipt for the group aged 45–54 in 1979. Pension benefit levels for this age group will increase similarly. These findings are consistent with research conducted by EBRI.

RELATIONSHIP BETWEEN EMPLOYER-SPONSORED PROGRAMS AND DEMAND FOR GOVERNMENT PROGRAMS

The long standing national policy of providing incentives through the tax laws for employer-sponsored employee benefits has encouraged the growth of the private employee benefit system. The benefits provided meet real economic security needs of workers and their families. The elimination of tax incentives for employee benefits will erode employer sponsorship and result in increased dependency on government programs. More specifically, reduction on elimination of the tax incentives would have the following effects:

Substantially raise the cost of providing benefits to either employer or employee or both.

Cause employers to cease offering some benefits, with the result that employees will have to obtain coverage individually at much higher cost.

Increase demand for government provided public benefit programs, which will probably not be as effective or efficient.

In the health care area, the widespread availability of private health insurance reduces government expenditures. As an example, through recent legislation, Medicare became the secondary payor for actively employed individuals over age 65. High medical bills, lengthy disabilities, or the death of a spouse all represent financial burdens that can quickly eliminate an individual's personal resources and require government's financial assistance if no other support is available. Any significant reduction in the level of private sector health benefits would certainly be accompanied by a demand for government to increase its role in financing these benefits.

Modest levels of employee cost-sharing contribute to containing health care costs. If, however, changes in the tax laws encourage employers to require excessive employee cost-sharing for health insurance benefits, many employees, especially low income employees, will drop their benefit packages completely. This will increase costs for other insureds through adverse selection, and for all Americans if health care services are not paid for by those who use them.

EFFICIENCY OF EMPLOYER-SPONSORED EMPLOYEE BENEFITS VS. GOVERNMENT PROGRAMS

We believe that employer-sponsored programs provide benefits in the most efficient and economical manner. In the area of health care benefits, the group insurance mechanism is the most cost-effective way to provide a variety of benefits. Through the financial mechanism of group insurance, certain personal costs which generally fluctuate widely by individuals, are translated into moderate level expenses funded by employers and employees and payable on a regular basis. In group insurance, risk is transferred from the employer to a third party, thus protecting the employee from the adverse consequences of employer insolvency. The economies of distributing benefits through a large employer group reduce the cost for all individuals, making insurance affordable for most of the American public. The employer acts as an advocate for the employee, and is better able than the individual to negotiate cost-effective benefit plan design and to control claim costs. Administrative costs for group plans are normally less than one-third of the cost of similar individual plans.

Because the cost of employee benefits is a direct cost of doing business, employers are very interested in holding down the costs of providing benefits. Throughout the nation, employers have formed business coalitions to promote cost containment. CIGNA is supporting the efforts of these coalitions through a two-year $1 million matching grant program. In addition, we offer affordable benefit programs designed to contain costs. As an example, Connecticut General's REMEDI plan design provides first dollar coverage for several cost containment benefits, while subjecting higher cost or over-utilized services to coinsurance and deductibles. Overall plan costs are controlled through coordination of benefits and reasonable and customary fee limitations. The flexible benefit plan and flexible spending account are other examples of benefit design to contain costs. These types of plans create an incentive for employees to utilize their entire benefits package more judiciously by making trade-offs among the individual benefits in the package. Flexible benefit programs have the potential to control costs in a way that does not deprive the employee of any benefits which she/he may individually perceive as essential. The employee thus becomes a more active participant in controlling his or her benefit costs.

Well designed health benefits encourage preventive health care and enable individuals to secure assistance at a time when it can be done economically with a minimal loss of productivity. An individual without health benefits is more likely to delay soliciting medical/dental assistance until the health situation is so severe that it becomes life threatening or more expensive to treat.

In the area of pension and retirement savings benefits, employer-sponsored plans are not only more cost-effective because of the economies of group coverage, but, for many lower and middle income employees, savings for retirement through an employer-sponsored plan is the only way to assure that an adequate retirement income will be available. Social Security is intended to provide only basic income replacement and needs to be supplemented by private pensions and individual savings. Data compiled by EBRI indicates that pension coverage constitutes the major source of savings for more than half of current pension participants.

Finally, the private sector can adjust to the needs of individuals and accommodate them much more quickly and with more flexibility than public programs. Thus, for example, the emergence of coverage for alternative health delivery mechanisms, along with alternative financing mechanisms and flexible benefits packages recognizes the differing needs in our more mobile and diverse workforce.

A NATIONAL EMPLOYEE BENEFITS POLICY IS NEEDED

We strongly believe that now is the time to begin a full and open debate on employee benefits issues and to develop a national employee benefits policy. The issues involved in such a policy are very complex. We urge that they be better understood before any additional employee benefits legislation is enacted. Some of the issues which need to be further explored are:

The interrelationships between public and private programs.

The true costs of employee benefits programs:

The tax expenditure estimates for employee benefits programs are frequently misunderstood or misused. For example, the large tax expenditure for pensions seriously overstates the amount of revenue which would be gained if the tax deduction for employer contributions to pensions were eliminated.

There is much concern over "erosion" of the taxable wage base due to the growth of tax favored employee benefits. It is necessary, however, to clearly distinguish among the growth of legally required employer payments, fully taxable employee benefits, tax deferred benefits and tax exempt benefits to understand the extent of tax base erosion.

The economic contribution of private pension plans to capital formation.

The social goals of employee benefits and how well they are being met.

In the past few years, much needed research on these subjects has been undertaken and is beginning to yield results. Too often, employee benefit legislation has been enacted in a data vacuum. We strongly urge members of Congress to proceed cautiously in considering any further legislation affecting employee benefits. We offer our assistance. Our interest in a national employee benefits policy is not new. As indication of this interest, we are a co-sponsor this year of a series of four roundtable discussions, sponsored by the Government Research Corporation, on the topic of retirement policy and U.S. tax policy. The purpose of these discussions is to begin a national debate on retirement policy. Participants in the roundtable discussion include representatives from private industry, government policy and academic communities and represent a broad spectrum of views on employee benefits issues.

These hearings represent an important first step along the path we recommend. We look forward to assisting the Subcommittees in their efforts.

STATEMENT OF DEBORAH J. CHOLLET, PH.D.,* WASHINGTON, DC

Mr. Chairman, I am pleased to submit this testimony on the importance of employee benefits to the economic security of workers and their families. The tax preferences accorded particular kinds of employee benefits—pensions, health insurance, disability insurance and life insurance—have been instrumental in achieving broad participation among workers and important economic security for workers and their families. This was the purpose for which Congress granted tax preferences for these benefits and legislated nondiscrimination rules for qualifying plans. Today, most workers participate in pension and insurance plans through their employers. They have come to consider these benefits, and their tax status, as part of the same social contract that assures their entitlement to Social Security benefits, unemployment insurance and workers compensation insurance.

This testimony described the prevalence, distribution and importance of three different employee benefits: health, long-term disability, and life insurance. These benefits, together with employee pension plans, are the major elements of most employee benefit packages. Unlike pensions that provide for the future economic security of workers, however, health, disability, and life insurance provide current economic security for workers and their families. For most workers, these benefits are their only private insurance against the economic disruption of illness, permanent disability or death.

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*Deborah J. Chollet is a Research Associate of the Employee Benefit Research Institute, a non-profit, non-partisan public policy research organization. Before joining EBRI, she was a Senior Research Fellow at the U.S. Department of Health and Human Services, National Center for Health Services Research, and served on the faculty of Temple University.

I. EMPLOYER-PROVIDED HEALTH BENEFITS

Most people who have private health insurance receive all or part of their coverage from an employer group health insurance plan. In 1982, employer plans provided health insurance coverage to 80 percent of the total population that reported private insurance coverage from any source. These people include workers and their families at all levels of earnings and income.

A. Coverage.—Health insurance is the most common employee benefit provided to workers in the United States. In 1982, 84 million civilian nonagricultural workers reported coverage from an employer group health insurance plan. These workers represented nearly 78 percent of the nation's total civilian nonagricultural workforce (see Table 1).

TABLE 1.—DISTRIBUTION OF WORKERS COVERED BY AN EMPLOYER GROUP HEALTH INSURANCE PLAN BY LEVEL OF WORK FORCE ACTIVITY, 1982 [1]

Work force activity	Employer coverage			No employer coverage
	Total	Direct coverage [2]	Indirect coverage [2]	
PERSONS IN MILLIONS				
All workers	83.7	65.3	18.4	24.2
Full-time workers	65.1	58.3	6.8	11.8
Full year	49.4	46.1	3.3	5.3
Part year	15.8	12.3	3.5	6.5
Part-time workers	13.6	4.1	9.5	8.1
Full year	5.1	2.1	3.0	2.5
Part year	8.5	1.9	6.5	5.6
Self-employed	5.0	2.9	2.1	4.3
PERCENTS				
All workers	77.6	60.5	17.1	22.5
Full-time workers	84.7	75.8	8.9	15.3
Full year	90.4	84.3	6.1	9.6
Part year	70.7	55.0	15.7	29.3
Part-time workers	62.3	18.8	43.8	37.4
Full year	66.7	27.9	38.8	33.3
Part year	60.3	13.8	46.5	39.7
Self-employed	53.6	30.8	22.8	46.4

[1] Includes civilian nonagricultural workers, except those living in families in which the greatest earner is a member of the Armed Forces or an agricultural worker.

[2] Direct coverage is defined as coverage provided by the worker's own employer plan at any time during 1982; indirect coverage is coverage received as the dependent of another worker in 1982.

Note.—Items may not add to totals because of rounding.

Source: EBRI tabulations of the March 1983 Current Population Survey (U.S. Department of Commerce, Bureau of the Census).

Rates of employer group health insurance coverage are particularly high among workers who are employed full-time throughout the year, the largest sector of the workforce. In 1982, more than 90 percent of full-time full-year workers were covered by an employer group health plan.[1]

Although most workers (60 percent) have coverage from their own employer plan, dependents' coverage is an important source of coverage for many, particularly for workers who are employed only part-time or during part of the year. In 1982, 29.4 million part-time or part-year workers were covered by employer group health plans. About half (44 percent) of these workers were covered as the dependents of other covered workers.

Dependents' coverage from employer health plans is also an important source of health insurance coverage among nonworkers, and particularly among children. In 1982, more than half of all nonworkers under the age of 65 (52 percent) were covered by an employer group health insurance plan (see Table 2). Most of these people (77 percent of covered nonworkers) were children under age 18; the rest were nonworking adults, including a small number of retirees under age 65.

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[1] By comparison, 56 percent of all workers, and 70 percent of the ERISA workforce, participated in an employer pension plan in 1983. Employee Benefit Research Institute, "New Survey Findings on Pension Coverage and Benefit Entitlement, *EBRI Issue Brief*, No. 33 (Washington, D.C.: Employee Benefit Research Institute, August 1984).

TABLE 2.—DISTRIBUTION OF NONELDERLY PERSONS COVERED BY EMPLOYER GROUP HEALTH INSURANCE PLANS, BY WORKER STATUS, 1982 [1]

Worker status	Number of persons with coverage (in millions)	Percent of persons with coverage	Percent of all persons with coverage
All persons [2]	130.8	67.5	100.0
Workers [3]	83.7	77.6	64.0
Nonworkers	47.1	54.9	36.0
Children	40.4	64.2	27.6
Others	11.0	37.7	8.4

[1] Includes all civilians except those living in families in which the greatest earner is a member of the Armed Forces or an agricultural worker.
[2] Items may not add to totals because of rounding.
[3] Includes civilian nonagricultural wage and salary workers and self-employed workers.

Source: EBRI tabulations of the March 1983 Current Population Survey (U.S. Department of Commerce, Bureau of the Census).

B. Tax incentives.—High rates of worker participation in employer group health plans is encouraged by both the tax code and the way that group health insurance is priced. Employer contributions to health insurance have been statutorily exempt from individual income and Social Security taxation since 1954. These exemptions have encouraged worker demand for employer-provided health insurance at all income levels. In additions, the Social Security tax exemption has provided a financial incentive for employers to offer health insurance benefits in lieu of wage compensation to workers who earn less than the Social Security ceiling on taxable wages. In 1983, nearly 95 percent of all workers earned less than the Social Security ceiling. The combination of these tax incentives for workers and employers has produced high rates for worker coverage at all income levels.

Aside from the tax code, other incentives have also encouraged wide participation in employer group health insurance plans. The pricing of employer group health insurance has apparently been an important factor in expanding employee coverage by encouraging larger employee pooling arrangements. In general, the package of benefits that insurers are willing to underwrite for a small employee group is less generous (per premium dollar) than the benefit package available to members of a larger plan. By offering health benefits to all employees, employers who purchase insurance (either primary coverage or stop-loss coverage for a self-insured plan) may find that the incremental cost of providing health insurance is low relative to the value of improved coverage to all workers. To maximize employee participation in the plan, and to enhance the plan's cost-efficiency, however, employee contributions to the plan are generally kept low.

Greater participation in employer health insurance plans has also been encouraged by the rising cost of individual coverage. As preferred health insurance risks (prime-age working adults and their dependents) have been absorbed into employer group plans, the cost of individual private health insurance coverage has risen. Recent changes in the tax code have further reinforced the attractiveness of employer plan participation relative to the purchase of individual coverage. While employer contributions to health insurance remain tax-exempt, the 1982 Tax Equity and Fiscal Responsibility Act (TEFRA) reduced tax preferences for individual insurance purchase, widening the disparity between the tax treatment of employer-based coverage and the purchase of individual coverage.

C. Equity.—Employer group health insurance coverage is possibly the most egalitarian employee benefit provided to workers in the United States. Employer health plans include the spectrum of workers at all levels of earnings; rates of coverage among all workers except those at the very lowest annual earnings level—generally with fragmented employment patterns—are highand roughly equal. Furthermore, the value of health insurance benefits shows little variation among workers.[2] As a result, employer-provided health insurance is a particularly valuable beneift for low- and middle-income worker: for these workers, employer contributions to coverage represent a proportionately larger real income supplement than they do for higher-income workers.

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[2] Employer contributions to health insurance, as reported in the 1977 National Medical Care Expenditures Survey, showed no significant variation by worker earnings. Gail R. Wilensky and Amy K. Taylor, "Tax Expenditures and Health Insurance; Limiting Employer-Paid Premiums," Public Health Reports (July/August 1982), table 2.

Most workers covered by an employer group health plan are low- and middle-income workers. In 1983, more than 80 percent of all workers covered by an employer group health insurance plan earned less than $30,000; and more one-third earned less than $15,000 (see Table 3). Only 5 percent of all workers covered by an employer group health insurance plan in 1982 earned more than $40,000.

TABLE 3.—DISTRIBUTION OF WORKERS COVERED BY AN EMPLOYER GROUP HEALTH INSURANCE PLAN BY PERSONAL EARNINGS, 1982 [1]

Personal earnings	Workers with employer coverage [2] (in millions)	Percent of workers within earnings group	Percent of all workers with employer coverage
Loss	0.4	43.4	0.5
$1 to $4,999	15.2	56.2	18.2
$5,000 to $7,499	6.6	65.9	7.9
$7,500 to $9,999	6.6	74.8	7.9
$10,000 to $14,999	15.8	85.1	18.9
$15,000 to $19,999	12.7	90.4	15.2
$20,000 to $24,999	9.6	92.8	11.4
$25,000 to $29,999	6.3	93.9	7.6
$30,000 to $34,999	3.9	93.3	4.6
$35,000 to $39,999	2.1	93.6	2.5
$40,000 to $49,999	2.1	91.7	2.5
$50,000 to $59,399	1.0	92.3	1.2
$60,000 to $74,999	.6	89.4	.7
$75,000 or more	.7	86.9	.9
Total, all workers [3]	83.7	77.6	100.0
Summary:			
Loss to $14,999	44.7	68.2	53.4
$15,000 to $24,999	28.6	91.9	34.2
$25,000 to $39,999	6.0	93.4	7.2
$40,000 or more	4.4	90.7	5.3

[1] Includes nonagricultural civilian workers who reported employer group health insurance coverage at any time during 1982; excludes workers in families in which the greatest earner is a member of the Armed Forces or an agricultural worker.

[2] Includes coverage from the worker's own employer group plan or from the plan of another worker.

[3] Items may not add to totals because of rounding.

Source: EBRI tabulations of the March 1983 Current Population Survey (U.S. Department of Commerce, Bureau of the Census).

The common allegation that employer health insurance primarily benefits high-income workers is not supported by national population survey data. Rates of worker coverage by employer plans are high and stable at all levels of earnings above $15,000. Even though workers who earned less than $15,000 reported somewhat lower rates of employer coverage in 1982, the number of workers in that earnings group is very large. As a result, more than half of all workers who were covered by an employer group health plan in 1982 earned less than $15,000.

The income distribution of all people covered by an employer group health insurance plan—covered workers and their dependents—mirrors the distribution of covered workers by earnings. Table 4 presents the family income distribution of all people covered by an employer group health insurance plan in 1982. More than half of these people lived in families with total family income less than $30,000; nearly three-quarters lived in families with income less than $40,000.

TABLE 4.—DISTRIBUTION OF PERSONS COVERED BY AN EMPLOYER GROUP HEALTH INSURANCE PLAN BY FAMILY INCOME, 1982 [1]

Family income	Persons with employer coverage (in millions)	Percent of persons within income group	Percent of all persons with employer coverage
Loss	0.1	5.5	0.1
$1 to $4,999	1.3	9.2	1.0
$5,000 to $7,499	2.1	21.2	1.6
$7,500 to $9,999	3.4	36.4	2.6
$10,000 to $14,999	12.2	56.2	9.3
$15,000 to $19,999	14.8	68.2	11.3
$20,000 to $24,999	17.8	78.2	13.6
$25,000 to $29,999	17.3	83.9	13.2
$30,000 to $34,999	15.0	86.3	11.4
$35,000 to $39,999	11.8	86.9	9.1
$40,000 to $49,999	15.9	87.0	12.2
$50,000 to $59,999	8.3	87.1	6.3
$60,000 to $74,999	5.7	86.2	4.4
$75,000 or more	5.2	84.6	4.0
Total, all persons [2]	130.8	67.5	100.0
Summary:			
Loss to $14,999	19.1	33.4	14.6
$15,000 to $29,999	49.8	76.7	38.1
$30,000 to $39,999	26.8	86.6	20.5
$40,000 or more	35.1	86.5	26.8

[1] Includes civilians who reported employer group health insurance coverage at any time during 1982, except civilians living in families in which the greatest earner is a member of the Armed forces or an agricultural worker.

[2] Items may not add to totals because of rounding.

Source: EBRI tabulations of the March 1983 Current Population Survey (U.S. Department of Commerce, Bureau of Census).

The income distribution of workers and their families who receive coverage from an employer group health plan is important for several reasons. First, since most people covered by an employer health plan are members of low- and middle-income families, employer-provided health benefits probably substantially raise rates of private health insurance coverage throughout the nonelderly population. Research conducted by the Employee Benefit Research Institute (EBRI) and others indicated that income is an important determinant of individual health insurance purchase among people without access to coverage from an employer; if employers did not provide health coverage, most low-income workers would not purchase private health insurance.[3] Economic research has consistently found that the lack of health insurance poses a significant barrier to health care access among low- and middle-income families.[4]

Second, the income distribution of people with employer coverage suggests that a tax on employer contributions to health insurance would, in effect, target low and middle-income workers who constitute more than 80 percent of all workers covered by an employer group plan.

Because employer contributions to health insurance are not significantly related to income, taxing employer contributions to health insurance would also be regressive. That is, the additional tax payment of low-income workers relative to their income would be much higher than the additional tax payment of high-income workers. EBRI tabulations of data produced by the Congressional Budget Office (CBO) indicate that a tax cap on employer health insurance contributions would be regressive at every income level; as a precent of income, people with the lowest incomes would pay more than six times the amount of additional tax paid by people with income above $50,000.[5]

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[3] Deborah J. Chollet, Employer-Provided Health Benefits: Coverage, Provisions, and Policy Issues (Washington, D.C.: Employee Benefit Research Institute, 1984), p. 94. An EBRI simulation of private health insurance suggests that 56–87 percent of all covered workers with 1979 family income less than $15,000 would not have purchased private health insurance, if an employer had not offered and contributed to their health insurance plan.

[4] See, for example, Alan C. Monheit, Michael M. Hagan, Marc L. Berk, and Gail R. Wilensky, "Health Insurance for the Unemployed: Is Federal Legislation Needed?", Health Affairs 3:1 (Spring 1984), pp. 101–111.

D. Efficiency of tax preferences: What are the alternatives?-Proposals to revise or eliminate tax preferences for employer group health insurance have come from several quarters. The Administration has proposed a cap on the tax exemption of employer contributions to health insurance, both to raise revenue and to discourage generous health insurance benefits in employer plans. The most recent Advisory Council on Social Security also advocated a tax cap, suggesting that Congress earmark part of the general revenue from the new tax to Medicare's Hospital Insurance trust fund. Those who have proposed comprehensive tax reform (for example, the Bradley-Gephardt bill) suggest that all employer contributions to health insurance be fully taxed as employee earnings.

These proposals raise several issues. They would potentially enhance federal revenues by broadening the tax base. The prospect of worsening federal tax regressivity among middle-income workers, however, is a major argument against including employer health insurance contributions in taxable income. There is, however, an additional issue to consider: whether current tax preferences, given their public cost in foregone tax revenues, is a better system for ensuring wide access to health care than alternative systems might be.

Proposals to establish a national health insurance plan have been introduced in virtually every session of Congress during the last fifteen years. These proposals have differed in the populations they sought to serve, the kinds of health care expenses they would cover, and their method of financing health care. Last year, the Congress considered legislation that would provide basic health insurance for people who lose employer coverage as a result of unemployment. All of these proposal failed in Congress because their projected public cost was prohibitive. Even so, most proposals for a national health insurance plan—including both major proposals to provide health insurance to the unemployed—rely on employer health insurance plans as the primary providers of health insurance.

The level of tax expenditures associated with the tax exemption of employer contributions to health insurance (estimated at $17.6 billion in 1984)[6] may be a very low price to pay for a system of health insurance that serves more than 60 percent of the population. Federal spending for Medicare, by comparison, is estimated at $62.2 billion dollars in 1984; 1984 federal-state spending for Medicaid is estimated at another $37.8 billion.[7] Together, these public programs finance health care services for only about 18 percent of the population.

Moreover, the cost of public insurance programs—in particular, the Medicaid program—may be substantially reduced by employer coverage of low-income workers. A simulation of private health insurance coverage among workers and their dependents in the absence of tax preferences for employer contributions to coverage suggests that the rate of private health insurance coverage among the working population might be significantly lower—and the rate of Medicaid coverage significantly higher—were low-income employees required to pay the full cost of health insurance for themselves and their dependents.[8]

The central position of employer-provided plans in our system of health insurance is illustrated by the low rates of alternative health insurance coverage—private or public—reported by the nonelderly population without coverage from an employer plan. Only 26 percent of all people living in families of civilian nonagricultural workers without employer group coverage reported coverage from another private health insurance plan in 1982 (see Table 5). Another 29 percent reported public program eligibility, predominantly for Medicaid. Nearly half (48 percent) of all people living in worker families without employer coverage reported no health insurance coverage from any source during the year. These people—totalling 30 million in 1982—are the largest segment of the uninsured in the United States.[9]

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[5] Deborah J. Chollet, Employer-Provided Health Benefits, p. 100.

[6] Budget of the U.S. Government, Fiscal Year 1985, Special Analysis G.

[7] Figure includes estimated total 1984 Medicare HI trust fund disbursements and 75 percent of estimated 1984 SMI trust fund disbursements reported in: U.S. Department of Health and Human Services, Health Care Financing Administration, Bureau of Data Management and Strategy, "Summary of the 1983 Annual Reports of the Medicare Board of Trustees, Health Care Financing Review 5:2 (Winter 1983), pp. 3 and 8. Unpublished Medicaid spending estimates were provided by the U.S. Department of Health and Human Services, Health Care Financing Administration.

[8] Deborah J. Chollet, Employer-Provided Health Benefits, p. 93.

[9] Estimates of noncoverage among the civilian nonelderly population generally range between 14 and 16 percent. Members of civilian nonagricultural worker families without private health insurance coverage or public program eligibility accounted for more than four-fifths of all people without health insurance coverage in 1982.

TABLE 5.—DISTRIBUTION OF PERSONS WITH PRIVATE HEALTH INSURANCE OR PUBLIC PROGRAM ELIGIBILITY BY EMPLOYER HEALTH INSURANCE COVERAGE, 1982 [1]

Persons with employer coverage	Other source of coverage		Persons without employer coverage	
	Number of persons (millions)	Percent of all persons with employer coverage	Number of persons (millions)	Percent of all persons without employer coverage
All persons	130.8	100.0	62.9	100.0
Other private coverage	7.8	5.9	16.1	25.6
Any public coverage	5.3	4.1	18.3	29.1
Medicaid	1.9	1.5	13.6	21.6
Medicare	.4	.3	2.4	3.8
CHAMPUS [2]	3.1	2.4	3.3	4.9
No coverage, any source			30.3	48.2

[1] Includes all people under age 65 living in families of civilian nonagricultural workers in 1982.
[2] The Civilian Health and Medical Plan of the Uniformed Services.

Source: EBRI tabulations of the March 1983 Current Population Survey (U.S. Department of Commerce, Bureau of the Census).

E. *Summary and concluding remarks.*—Employer group health insurance plans are the basis of most private health insurance in the United States. In 1982, 80 percent of all people with private health insurance coverage were covered by an employer plan; half of all people without coverage from an employer plan are uninsured from any souce. These people living in worker families without employer coverage represent most of the uninsured population in the United States.

Most of the workers who are covered by an employer health insurance plan are low- and middle-income workers. In 1982, more than half of all workers with employer health insurance coverage earned less than $15,000; 88 percent of all covered workers earned less than $25,000. This distribution of covered workers by earnings is mirrored in the distribution of all people covered by an employer plan by family income. More than half of all people—workers and their dependents—covered by an employer plan in 1982 reported family income less than $30,000. The primary alternative source of coverage among workers and their dependents without employer coverage was Medicaid.

The tax exemption of employer contributions to health insurance are currently being reevaluated as a potential source of new federal revenues. The tax revenues to be gained, however, may be small compared to the potential costs of jeopardizing a system of private insurance that protects more than 130 million workers and dependents. Econometric estimates of private health insurance purchased among workers and their dependents suggest that significant numbers of people now covered by an employer plan would not purchase private health insurance if it was not offered—and largely paid for—by an employer.

Further, potential revenues from the taxation of employer health insurance contributions must be compared to potential increases in public insurance program spending—particularly by Medicaid. In 1982, 86 percent of nonworkers covered by employer plans were dependent children under age 18. In all states, recipients of AFDC benefits [10] are categorically eligible for Medicaid; furthermore, in some states, dependent children in any low-income family are categorically eligible for Medicaid.[11] The loss of employer coverage among low-income workers, therefore, could impose significant costs on state Medicaid programs. Potential increases in existing public program costs, and the potential for significantly higher rates of noncoverage in worker families, are important considerations in the debate over reducing tax preferences for employer contributions to health insurance.

II. EMPLOYER-PROVIDED DISABILITY AND LIFE INSURANCE BENEFITS

Employer group disability and life insurance plans provide income replacement for workers and their dependents in the event of the worker's total disability or death. Although no population survey data exist to document the prevalence and distribution of life and disability insurance benefits among workers, published data from a national survey of medium-size and large establishments suggest that life and disability insurance benefits are about as widely held among workers as health insurance. The data presented in the following sections are drawn from the Level of Benefits (LOB) Survey of full-time employees in medium-size and large establishments. This survey is conducted annually by the Department of Labor, Bureau of Labor Statistics, and reflects plan participation as of January 1 of the survey year.

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[10] Aid to Families with Dependent Children (AFDC) is a state-based, federal matching program that provides income assistance for low-income families with dependent children. Eligibility criteria are established by the states within broad federal guidelines.

[11] In 1982, 20 states provided Medicaid coverage for all financially eligible persons under age 18. Deborah J. Chollet, Employer-Provided Health Benefits. pp. 22–24.

A. Long-term disability insurance.—The purpose of long-term disability insurance is to provide earnings replacement for workers who become permanently and totally disabled. Long-term disability coverage can be provided through an insurance policy, or through the worker's pension plan. In 1982, about 43 percent of full-time workers in medium-size and large establishments participated in an employer group disability plan; 49 percent participated in a pension plan that would provide immediate retirement benefits if the worker became disabled (see Table 6). In total, about 92 percent of all full-time workers have disability coverage provided by an insurance or pension plan.

TABLE 6.—*Percent of full-time employees participating in employer health, long-term disability, and life insurance plans, medium-size and large establishments, 1982* [1]

[Participants as a percent employee benefit plan of all full-time employees]

Health insurance for employee [2]	97
Noncontributory [3]	71
Health insurance for dependents [2]	93
Noncontributory	44
Long-term disability insurance	43
Noncontributory	33
Retirement pension with immediate disabillty retirement provision	49
Noncontributory	([4])
Life insurance	96
Noncontributory	82

[1] Participation is defined as coverage by a time off, insurance, or pension plan to which the employer contributes. Employees subject to a minimum service requirement before they are eligible for a benefit are counted as participants even if they have not met the requirement at the time of the survey. In contributory plans, only employees who elect and contribute to coverage are counted as participants. Benefits to which the employer does not contribute are outside the scope of the survey. Only current employees are counted as participants; retirees who participate in the benefit program are excluded.

[2] The employee or dependents may be covered by a working spouse's plan instead of, or in addition to, participation in the surveyed employer plan.

[3] All coverage in the benefit program is provided at no cost to the employee. Supplemental life insurance plans, not tabulated here, may be contributory.

[4] Published tabulation not available.

Source: U.S. Department of Labor, Bureau of Labor Statistics, Employee Benefits in Medium and Large Firms, 1982, Bulletin 2176 (August 1983), pp. 6 and 16.

Since earning replacement is the goal of disability insurance coverage, the contribution amounts (from either the employer or employee) and the amount of plan benefits vary by employee earnings. In 1982, two-thirds of full-time employees with disability insurance plans contributed to the plan; employee contributions for disability insurance, however, were low—usually les than one percent of employee earnings. Private pension plans are seldom contributory.

Long-term disability insurance plans usually integrate Social Security, workers' compensation, or other disability-related public program payments. That is, the plan subtracts the amount of these payments from the insurance benefit paid to the disabled worker. Social Security DI is an income-redistributive program. The rate of earnings replacement in the DI program is substantially higher for workers at lower earnings levels than for those with greater earnings.[12] Because DI replacement rates, in particular, are inversely related to income, the integration of public program benefits probably raises the value of employer-provided disability insurance coverage relative to predisability earnings among higher-wage workers.

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[12] Social Security replacement rates vary inversely with the individuals covered wages. For an average-age disabled person with lifetime covered earnings at the minimum wage, 1984 Social Security Disability Insurance payments would replace 62 percent of predisability earnings. With lifetime covered earnings at the average wage, earnings replacement is 43 percent. With lifetime covered earnings at the Social Security ceiling ($37,800 in 1984), earnings replacement is only 24 percent.

Integration of public program benefits in private disability plans, however, have at least two additional effects. First, the integration of DI and other public disability transfers may rationalize the assistance provided by independent public disability programs. Integration of public assistance payments assures a more uniform level of earnings replacement for all workers, reducing the higher rate of earnings replacement from DI among low-wage workers.

Secondly, integration avoids "excessive" cumulative earnings replacement from independent public programs. In general, public-program benefits (DI, workers' compensation, and a variety of other cash and noncash programs conditioned on disability) are independent and tax-exempt. The accumulation of these benefits can equal or even exceed predisability after-tax earnings. The accumulation of public program benefits, therefore, together with private disability insurance programs, can provide a strong incentive for the disabled to remain outside the workforce. The integration of public program benefits in employer disability plans mitigates the potential work disincentives created by overlapping disability assistance, reducing both private and public disability insurance costs. Integration is likely to be most effective in encouraging low-wage disabled workers to return to work, since integration particularly reduces "excessive" earnings replacement among these workers. The work incentive effects of integration, however, have not been carefully investigated in existing research.

In 1982, two-thirds of all workers who participated in an employer disability insurance plan were guaranteed long-term disability benefits, after integration, of 50 to 60 percent of pre-disability earnings, subject to maximum payment limits or ceilings on disability income.[13]

B. Employer-provided life insurance.—Nearly all full-time employees in medium-sized and large establishments participate in an employer-sponsored basic life insurance plan. Like disability insurance, basic life insurance benefits are generally intended to provide income to replace lost earnings. The amount of basic coverage provided by employer plans, therefore, is usually a multiple of the worker's earnings. In 1982, about two-thirds of plan participants in medium-sized and large establishments belonged to plans that paid 100 percent or 200 percent of the deceased worker's annual earnings. One third of plan participants belonged to plans that paid a flat dollar amount, usually between $2,000 and $15,000.

In addition to providing death benefits for worker's families, some basic life insurance plans provide a form of disability insurance by continuing coverage or paying immediate benefits to workers who become disabled. Life insurance plans may pay disability benefits in two ways. First, some plans provide a lump-sum or periodic distribution of the policy's face value to workers who become disabled. Second, some plans pay the face value, or a multiple of the face value, of the policy for accidental death or dismemberment; in cases of accidental dismemberment, disability is presumed. In 1982, nearly all full-time workers (99 percent) who participated in an employer group life insurance plan were entitled to extended coverage or distribution of the policy's face value if they became disabled. Nearly three-quarters (72 percent) had coverage that provided accidental death or dismemberment benefits.

Lacking population survey data, the importance of employer-provided coverage as a source of life insurance coverage for workers and their families is difficult to evaluate. Certainly, the wide participation by full-time workers in medium-size and large employer plans suggests that these plans are a major source of life insurance coverage among workers. Furthermore, although employer-provided basic life insurance is not intended to provide adequate life insurance coverage for most workers, only a small proportion of employees in medium-size and large establishments elect supplemental group life insurance coverage—even when the employer contributes. Low participation rates in supplemental plans by full-time workers suggests that many employees may have no private life insurance coverage outside of the basic plan paid by the employer.

C. Efficiency of tax preferences: What are the alternatives?—Employer contributions to disability and life insurance are treated somewhat differently in the tax code; both, however are tax-favored. Employer contributions to disability insurance are tax-exempt. Individual income taxes are paid, however, on benefits actually received from a disability plan, including disability retirment, at the time of receipt. Like employer contributions to pension benefits, employer-paid disability insurance is tax-deferred.

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[13] Private pension plans do not integrate Social Security benefits as commonly as long-term disability insurance plans. In 1982, only 45 percent of all private pension participants in medium-size and large establishments belonged to plans that integrated or offset Social Security benefits. In general, white-collar employees (professional-administrative and technical-clerical workers) are more than twice as likely to have an integrated pension plan as are blue-collar (production) workers. Published data do not indicate whether pension plans that provide for immediate disability retirement are more likely to integrate Social Security and other public program benefits.

Employer contributions to life insurance valued at less than $50,000 are also tax-exempt.[14] In general, distributions from life insurance plans are exempt from individual income taxation as well. Neither employer contributions to disability or life insurance (under $50,000), nor the benefits ultimately paid by these plans, are taxable by Social Security.

The level of foregone federal revenues, or tax expenditures, associated with the exemption of employer contributions to accident and disability insurance is estimated at $120 million in 1984. Tax expenditures associated with the exemption of employer contributions to group term life are higher: $2.2 billion in 1984.[15]

For most workers and their families, public disability assistance and survivors' benefits are the most important alternative to employer-provided disability and life insurance plans. Several public-sector programs provide income security benefits comparable to private disability and life insurance. Social Security Disability Insurance (DI) is the largest public-sector program that pays benefits to permanently and totally disabled workers. Because entitlement for DI benefits, however, depends on the worker having a sufficient work history in covered employment, many workers are not currently insured by the DI program. In 1983, only about 62 percent of all workers were insured by Social Security for disability benefits. Estimated 1983 benefit disbursements from the DI trust fund were $17.9 billion

State workers' compensation programs are also an important source of disability insurance coverage for most workers: coverage by workers' compensation plans is nearly universal. However, these plans pay benefits only for work-related disability. These apparent gaps in public insurance program coverage suggest that employer-provided disability and life insurance plans are the primary source of disability and life insurance coverage for large numbers of workers.

Despite coverage by employer disability plans, Social Security, workers' compensation and other disability-related public plans most people who report being severely disabled--that is, unable to work at all or regularly because of a chronic health condition or impairment—report no income from any private or public disability plan. The 1978 Disability Survey conducted by the Social Security Administration found that only 42 percent of the 10.7 million persons who reported severe disability also reported receipt of public or private disability benefits.[16] More careful investigation of this apparent gap in income security for the disabled may be a starting point for reevaluating the adequacy and effectiveness of tax incentives for employer-provided plans, and the efficiency of employer plans as an alternative to public disability assistance.

The Social Security Old Age and Survivors Insurance (OASI) is the most prominant public-program alternative to employer-provided life insurance. In 1983, about 55 percent of all workers were insured (either permanently or currently) by OASI. Survivors' benefit payments from the OASI trust fund in 1982 totaled nearly $34 billion.

The level of Social Security expenditures for disability and survivors' benefits, given the share of all workers currently insured for these benefits, offers a rough idea of the potential public cost that might be associated with an essentially public system of disability and life insurance. It is likely that the additional cost of such a system would be far greater than the level of tax expenditures associated with current tax preferences for employer-provided plans.

Whether a revision of tax preferences for employer-provided plans would jeopardize private insurance coverage is an important issue in considering revised tax preferences for these benefits. In terms of potential coverage loss, the arguments against revising or eliminating tax preferences for employer-provided disability and life insurance plans may be weaker than the arguments against taxing employer-provided health insurance benefits. At the same time, the estimates of federal revenue loss associated with tax preferences for employer-provided disability and life insurance benefits are substantially smaller.

Like employer-provided health insurance, basic life insurance benefits appear to be evenly distributed among workers—particularly among full-time permanent employees of larger establishments. When the immediate disability retirement provisions of pension plans are included as a source of long-term disability coverage for workers, employer-provided disability insurance is probably also quite evenly distributed among workers. As a result, taxing employer contributions to these benefits (including employer contributions to pension plans) as employee earnings would probably target the low- and middle-income workers who constitute most of the working population.

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[14] Employer contributions to life insurance in excess of $50,000 are fully taxable as current income to the employee.

[15] *Budget of the U.S. Government, fiscal year 1985,* Special Analysis G.

[16] Congress of the United States, Congressional Budget Office, *Disability Compensation: Current Issues and Options for Change* (June 1982), p. 18.

Unlike employer contributions to health insurance, however, employer contributions to disability insurance, pensions, and basic group life insurance are usually calculated on the basis of employee earnings. Since employer contributions vary directly with earnings, taxation of these contributions is likely to be less regressive than taxation of employer health insurance contributions. A less regressive tax burden, in turn, suggests that coverage loss among low-income workers might be low relative to the loss of health insurance coverage anticipated from full or increased taxation of employer contributions to health insurance. Nevertheless, employer-provided disability and life insurance—including disability coverage provided by private pension plans—are an important supplement to the insurance offered by public disability and surviviors' insurance programs. Existing research has not investigated the coverage loss that might result from reducing tax preferences for employer disability and life insurance contributions, or the implications of private coverage loss for the economic security of workers and the cost of public insurance programs.

D. Summary.—Employer-provided disability and life insurance benefits are common components of employee benefit plans. Although fewer than half of all full-time permanent workers in medium-size and large establishments are covered by an employer-provided disability insurance plan, about 49 percent participate in a pension plan that provides immediate disability retirement benefits. Together, disability insurance and pension plans provide long-term disability coverage for about 92 percent of full-time permanent workers in medium-size and large establishments. Similarly, nearly all full-time permanent workers (96 percent) in these establishments participate in an employer-provided basic group life insurance plan.

Nearly all disability insurance plans integrate disability income from Social Security, workers' compensation insurance, or other public disability assistance programs. Integration of public-program benefits rationalizes total disability income, assuring more uniform levels of earnings replacement among workers and mitigating the work disincentives associated with very high earnings replacement. Because earnings replacement by Social Security, in particular, is greater for low-wage workers, however, integration probably also raises the relative value of employer-provided disability insurance for high-wage workers.

Like disability insurance, the goal of basic group life insurance plans is earnings replacement. Plan benefits are usually calculated as a multiple of the worker's earnings. As a result, the value of employer contributions to group life insurance is higher for employees at higher earnings levels.

The earnings replacement goals of employer-provided disability and life insurance plans might make the argument against revising their tax treatment somewhat weaker than the argument against reducing tax preferences for employer-provided health insurance. At the same time, the potential federal revenue gains are substantially smaller. Because the value of disability and life insurance benefits—and the level of employer contributions—varies with employee earnings, taxing employer contributions to group disability and life insurance plans is potentially less regressive than taxing employer contributions to health insurance. In turn, the loss of disability and life insurance coverage among low-income workers is potentially lower.

An important caveat is in order, however. No research exists that documents (1) the distribution of employer-provided disability insurance (including pension coverage that provides immediate disability retirement) or basic life insurance among all workers, or (2) the importance of employer-provided plans relative to other private and public sources of insurance coverage. Circumstantial evidence suggests that employer-provided disability and life insurance plans may be a critical source of income security for most workers. As the basis of our private system of income security for workers, employer-based disability insurance, pensions and basic life insurance are probably worth preserving. Maintaining effective tax incentives for employers to provide these benefits to workers at all earnings levels may be the most efficient means of assuring a successful private alternative to public assistance.

COMPREHENSIVE ACCOUNTING SERVICES,
Gates Mills, OH, September 10, 1984.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth Office Building, Washington, DC.

DEAR MR. SALMON: With respect to the forthcoming hearings on employer-provided fringe benefits, I would like to express my feelings on what I believe to be one of the most inequitable aspects of our current tax provisions.

Having worked in private industry for twenty five years prior to establishing my own business, and as a result of servicing many other small business such as my own, it has made me aware of how employer-paid medical plans is so discriminating against the sole proprietor, the unemployed widows raising families, and employees not fortunate enough to receive this wonderful fringe benefit.

Those people who have to provide their own overage are faced with monthly premiums of as much as $300, and sometimes even more, of after-tax dollars, whereas employer-provided hospitalization (including in many cases dental and eye care) is in effect non-taxable income and furthermore a deductible expense of the employer. True, the small person can include these premiums as a deductible medical expense if they are fortunate enough to accumulate enough deductions to qualify for the extra reduction of taxable income. But really, with the increased restrictions in arriving at allowable excess medical deductions, and the allowable itemized deduction exclusion ($3400 for family) it produces at best the possibility only of a severely watered-down benefit.

I trust that this specific item will be given strong consideration in your upcoming hearings.

Very truly yours,

PAUL W. GIESLER.

STATEMENT OF DR. ERIK D. OLSEN, CHAIRMAN, GOVERNMENT PROGRAMS COMMITTEE, DELTA DENTAL PLANS ASSOCIATION

Mr. Chairman, I am Dr. Erik D. Olsen, President of California Dental Service, the Delta Dental Plan of California, and Chairman of the Government Programs Committee of Delta Dental Plans Association. Delta Dental Plans Association is the national coordinating agency for the country's not-for-profit dental service organizations.

We appreciate the opportunity to testify and want to say at the outset that we believe that the existing tax incentives for health care benefits are responsible for a system that is fundamentally fair and that has ensured that the average employee has adequate health care coverage. Moreover, we believe that any change in the tax treatment of these benefits, for example, the proposal to limit the amount of employer-paid health insurance premium that would be considered tax-exempt could cause a serious diminution of the health care benefits of a large number of employees and their families.

Delta Dental Plans are separate, autonomous prepayment organizations under the jurisdiction or regulation of state insurance commissioners or attorneys general. As a result of Delta's support by the dental profession, and unique contractual relationships with participating dental practitioners, Delta Plans provide true "service" benefits, in contrast to indeminity payments, for the cost of treatment to covered subscribers.

An estimated 70,000 dentists, over two-thirds of the approximately 100,000 active practitioners in the United States, are presently contracting participants in Delta programs.

Delta Dental Plans design their programs to provide maximum dental care benefits to subscribers at reasonable cost to the program purchaser and the covered subscriber. Since all Delta Plans are not-for-profit, no portion of the benefit dollar is held for dividends to shareholders. All funds received by Delta Plans, therefore, are used to pay for services rendered to covered subscribers and eligible dependents and the administration of the program. Dental consultants are designated by the Plans to review the necessity, appropriateness and adequacy of care provided by participating dentists.

Delta plan administrative techniques, which have evolved from a first-hand awareness of the "elective" nature of most dental treatment, embody a cost containment concept most visible in such program design elements as deductibles, copayments and maximums, and in the determination of covered benefits by Pland dental directors and consultants. Basing their claims processing policies on professionally accepted standards of dental care, Dental Plan dental directors and consultants are able to effectively control areas of program over-utilization and other potential abuses.

Dental disease is the most extensive health problem in the United States today, and is almost pandemic with respect to its occurrence in the population. Dental diseases are not self-healing and cannot be cured by professional advice or medication alone. Without treatment, dental diseases continue their damage and proceed to become more severe. Some oral health problems have become so widespread that many people have accepted tooth loss and other complications of dental disease as inevitable.

A major difference between the public's view of medical and dental payments is that all too often people fail to relate oral disease to their general systemic health and well-being. Frequently there is a tendency to accept dental disease complacently because of the undramatic nature of most dental problems in their early stages. This casual acceptance of dental disease contributes greatly to the postponement of treatment.

Although the cumulative dental health problems of this nation are huge, remarkable progress can be made, and has been made, if the existing knowledge and science of dental treatment are put to use and made available to our citizens. The most economic and efficient way to improve the nation's oral health is to prevent dental disease. From the econimic standpoint, regular and routine preventive care and maintenance is the most cost-effective and efficient way to overcome both the human suffering and the hours of productive work time lost through the disabilities caused by the poor oral health of countless millions of Americans.

In recent years it has become widely accepted by health care professionals and economists that prevention might be used, not only to improve the health of Americans, but also to help contain the cost of their health care.

The basic idea is a simple one: relatively low cost investments in disease prevention and health education will prevent or postpone the onset of illness and disability requiring more expensive treatment. Thus, prevention succeeds as a cost containment mechanism if the dollars saved in future years exceed the current cost of the prevention effort, whether the savings are due to expenditures completely avoided or only delayed.

The experience of recent years in dental care through programs of preventive treatment and the mechanism of dental prepayment and insurance has been perhaps the most dramatic example of the principle of prevention in action.

Once thought "uninsurable," dental care has now joined hospital and medical/surgical coverage as a standard benefit in the employee benefit package in virtually all segments of the American work force. Dental prepayment has enabled and/or motivated a far greater number of people to obtain dental care than would otherwise have been possible. It is a demonstrated fact that a larger proportion of covered patients regularly seek dental care than do those without dental benefit programs.

Less than 20 years ago, nearly 65 percent of the population did not visit the dentist during a given year. Today, more than half of the population has one or more dental visits annually. Two factors have been critical to this improved picture: the emphasis on preventive measures, health care education and early diagnosis and treatment in the dental office and the growth of prepaid dental benefit programs to the point where 90 million Americans have dental care coverage today.

This expanded coverage has been made possible by the current tax policy toward fringe benefits. The existing tax incentives for employer provided health care benefits must be continued, in our judgment, if this pattern of improved health is to continue.

When the Congress was initially considering whether to place a limit on the amount of tax-exempt, employer-provided health care benefits last year, Delta commissioned a survey on the public's attitudes toward health care coverage. The survey was conducted by the nationally recognized Roper Organization, Inc. Eleven questions were asked of a nationwide cross-section of 4,000 men and women 18 years and older in face-to-face interviews in respondent's homes. This resulted in interviews with 2,242 employed people. A summary of the survey is attached to our statement, but I would like to summarize some of the key findings here today:

The survey confirmed earlier studies that those who have dental coverage go to a dentist more frequently than those who do not have coverage—nearly 4 in 10 who have coverage go to a dentist twice a year or more, compared with just 1 in 4 of those who do not have coverage.

When asked if the proposed limit on tax-exempt health care benefits would make a difference in reducing health care costs or reducing the federal deficit, a large plurality said it would not make a difference. This opinion was amazingly similar across the socio-economic spectrum as well as among men and women and conservatives and liberals.

Almost 8 out of 10 people interviewed had some degree of concern about the way that a limit on tax-exempt status of health benefits would affect their ability to continue to protect themselves and their families from illness or injury. Respondent's were asked, in the event of a "cap" on the tax-exempt status of their health benefits, if they would be willing to keep full coverage and pay more taxes or pay additional cost out of pocket. Using Roper's standard measurement to determine reliability of response, 76% of the respondents were likely to drop some parts of their health coverage.

This last point is the one we believe this committee should be concerned with, Mr. Chairman. With minimal encouragement the working men and women of this country can receive comprehensive health care benefits and we are a better nation because of it. Health care benefits are truely the universal fringe benefit.

I would like to emphasize that growth in dental benefit programs has been achieved without the extreme inflation in dental treatment fees that has afflicted other health care disciplines. While the number of Americans covered under dental benefits increased dramatically over the past decade from 12 million people, or 6 percent of the population, to 87 million, or over 33 percent at the end of 1982, the rate of increase in the cost of dental services actually was lower during this same period than the rate of increase for all services in 1970–82.

The typical dental benefit program differs from the hospital/medical program model in that the dental program is structured to provide greater benefits for diagnostic and preventive services with lesser benefits for restorative and replacement services. This approach creates financial incentives for program subscribers to seek preventive dental services on a regular basis and to establish sound home care habits (as shown by the Roper survey). The level of coverage for restorative services assures a sharing by the subscriber of the cost of those services, thereby encouraging the active participation and concern of the consumer.

Because susceptibility to dental disease is nearly universal, the need for preventive services to control such disease is highly predictable. Dental benefit programs, therefore, are not so much "insurance" as they are a means of prepaying the cost of prevention and treatment. To a large extent, the seeking of dental care at any given time is a discretionary act by an individual. For a dental care program to be financially feasible and stable in its operation, however, it is necessary that enrollment of the subscriber population be accomplished through a single decision by a group purchaser rather than through decisions by each member of the employee group.

As a practical matter, most prepayment organizations and insurance carriers will not enroll groups of 25 or less employees. Dental benefit programs are sold only on a group basis, not to individuals.

The key to a dental program's stability is that individuals in the group represent the entire spectrum of dental care needs including both those who require an extensive amount of dental treatment involving many dental visits and a relatively high overall cost as well as those individuals who may rarely require dental care services. A dental benefit program involves establishing a per-person cost for the entire group, regardless of the level of need, in order to cover the cost of the services required by the group. To permit individuals within a group to withdraw on the basis of their own limited need or desire—as the survey indicates might well happen—immediately has the effect of substantially increasing the cost of the program for the individuals electing to retain dental coverage. This effect occurs when individuals, knowing they may not immediately require dental care, or who have recently had extensive dental treatment, or who wish to postpone necessary health care, withdraw from the population base. This creates an "adverse selection" situation, which in turn forces the costs of dental benefit programs to escalate substantially.

As we have intuitively believed, and as the Roper survey now clearly shows, changes in tax incentives affecting health care benefits will have a materially adverse affect on dental care coverage and, ultimately, the helath of working men and women and their families.

In closing, Mr. Chairman, I would like to summarize by saying that dental benefits are on the way to becoming universal, significantly improving the oral health of America and encouraged by the present tax incentives. As the Roper survey demonstrates, almost half of working Americans do not believe that changing their incentives would have a favorable impact on either health care costs or the federal budget deficit. Further, that an alarmingly high 76% of working Americans would drop some health benefits. Therefore, I would urge this committee, in its future deliberations, not to change those incentives that are fundamentally fair and fundamentally sound in their effect.

EXECUTIVE SUMMARY OF DELTA DENTAL PLANS ASSOCIATION

ROPER POLL SHOWS WIDESPREAD OPPOSITION TO TAX ON HEALTH CARE BENEFITS

In a nationwide opinion survey, nearly half those interviewed said that a tax on health care benefits would not be helpful in controlling health care costs (see pages 31-33). In the same survey, nearly 76% of those questioned said that they were not "very certain" that they could keep their present health care benefits if such a tax were imposed (see pages 23-25).

The poll was taken by the Roper Organization, Inc. in the late summer of 1983 with the full analysis of results being released now by Delta Dental Plans Association, who commissioned the survey. Delta Plans covered 15 millon people and paid out an estimated $1 billion in benefits to covered subscribers.

The possibility of a tax being imposed on health care benefits was raised frequently during the 1983 Congressional session. Hearings were held on the proposal (S-640) but no further action was taken. It is anticipated that the measure will receive further attention in 1984.

A broad range of interests including labor, management, health and insurance groups—opposed the measure. Organized dentistry offered particularly active opposition on the grounds that the copayments and deductibles that are typical of dental benefit programs already limit costs significantly in comparison with other health insurance benefits and that these co-payments and deductibles offer a model Congress might consider following rather than penalizing.

Widespread opposition

Among those polled who felt that a tax on health would not be purposeful, there was a striking similarity on this view from all segments of society, as the excerpt below from the tables on pages 31 and 32 demonstrates:

Percentage saying tax wouldn't help.—College graduate, 48; non-high school graduate, 45; executive professional, 48; blue collar, 48; men, 48; women, 46; conservative, 46; and liberal, 47.

When subtracting those not answering or giving an equivocal answer to the question of a health benefits tax being useful, the poll shows a remarkable consensus across the entire spectrum of society believing that such a tax is ill advised and purposeless.

The national opinion survey commissioned by Delta showed, as well, that a large majority of people weren't sure they could retain all of their present health care benefits if such a tax was imposed. As the comments by the Roper Organization indicate, only those who indicated they were "very certain" about their answer can be fully expected "to hold to these choices" (page 12). On that basis nearly 8 out of 10 people interviewed had some degree of concern about the way in which a tax would harm their ability to continue to protect themselves and their families from illness or injury. Once again, this widely held concern was repeated within nearly all the subsets of the population, as the following excerpt from the tables on pages 23 and 24 shows:

Percentage less than "very certain" about effects of tax.—College graduate, 74; non-high school graduate, 80; executive professional, 68; blue collar, 79; men, 73; women, 79; conservative, 75; and liberal, 75.

In addition to these questions on the proposed tax on health benefits, the Roper poll, confirmed for the first time in hard figures a measure of the way in which dental insurance has become a common, highly valued health benefit and, as well, the poll makes it possible to draw profiles, again for the first time, of a typical beneficiary of it as well as one of those who do not yet have this benefit.

Ninety million covered

The survey shows that some 42% of the nation now have dental benefits, an estimated 90 million people. Far more people in the western sector of the nation, 51%, have benefits today while the southern states lag behind with 32%. Nearly half of those employed full-time, 49%, have dental coverage while 70% of union members benefit from it. Among the array of health care benefits available through employment, only hospitalization, physician costs and major medical plans cover a larger percentage of the population than does dental prepayment.

Among those groups within the population who are least benefitted as yet by dental prepayment are those with family incomes of less than $10,000, 13%; those who live in the least urbanized parts of the country, 27%, and, as mentioned, those who live in the South, 32%.

Though dental coverage was practically unknown on a national scale as recently as 15 years ago, the Roper poll indicates that it has quickly become a highly valued benefit. When those surveyed were asked what parts of their total health care coverage they might consider terminating, only 16% of those employed full-time and 15% of those now having coverage mentioned dental prepayment as one of the first two or three things they would surrender (page 28).

A further indication of the value of this relatively new benefit is shown by the answers to two questions asked only of those who do not now have dental prepayment. When asked why they didn't have it, 43% said it was because the employer Delta Dental Plans Association is a national network of not-for-profit State Plans offering group prepaid dental benefit programs. In 1983, didn't offer it while only 16% had other reasons (page 34). When asked whether they would take it if offered by the employer, nearly three out of four said they would and nearly half said they would even if the employer didn't pay the full premium.

Dental health habits

The Roper poll, finally, asked those surveyed about their dental health habits. Some 74% of those employed full-time and having dental coverage said they saw the dentist about once a year or more often while 61% of those employed full time but without coverage said the same. The higher percentage for those with coverage is believed by dental experts to be good news from a cost standpoint since it means such people are more likely to have a good state of dental health and are having problems corrected early, when it is less expensive to do so.

In 1982, according to government figures, the national dental care bill was some $19 billion out of a total health care bill of $308 billion. Unlike medical and hospital spending, dental care expenditures are almost entirely from the private sector, with only some 4% of the total being public funds as opposed to 44% for the hospital-medical sector. This makes private funding of dental prepayment of particular importance to the workforce since there is essentially no public support for dental care cost. The Delta Dental System is the oldest carrier of dental benefit programs in the nation and, in 1982, its benefits payments accounted for some 20% of the total of such payments made.

HADDON CRAFTSMEN, INC.,
Scranton, PA, September 21, 1984.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth Office Building, Washington, DC.

DEAR MR. SALMON: The following considerations are respectfully submitted in connection with the points on which your office is seeking expressions of opinion regarding the Committee hearings on the distribution and economics of employer-provided fringe benefits. The viewpoint expressed is representative, I feel, of the way most relatively small businesses view the possibility of completely changing the existing concepts of taxation in regard to such benefits. In this context, by a small business I refer to the numerous companies with 500 to 5,000 employees, (somewhat larger than the SBA definition of small business), with gross revenues in the range of $25,000,000 to $200,000,000. These companies are large enough to deal beyond local markets, yet small enough to be close to and responsive to both customers and employees.

Nontaxable fringe benefits are very prevalent in such companies, though not necessarily in the most complex or newly fashionable forms. Instead, emphasis is on a wide range of basic benefits, such as medical/surgical coverage, basic group life insurance, some form of income continuation in the case of short term illnesses, and also some provision for benefits to those who encounter long-term disability.

Being basic type programs, they are usually offered to all classes of employees, without distinction between salary ranges, or type of work. Many times, depending on industry, these benefits are provided under collective bargaining agreements. More often than not, when that is the case, similar benefits will also be given to other employees. Part time or temporary employees may be excluded, where permitted, only because giving them the same benefits would not be fair to full time employees.,

The tax structure is not a major factor in the selection of benefits, especially where the benefits are union negotiated. Most coverages are viewed as protection against undesirable eventualities, rather than as an alternative to taxable compensation. In negotiating situations, wage increases are still the item of choice; additional fringe benefits are sought when there is a perception that existing benefits are inadequate, not because of tax considerations. The majority of individuals are still more concerned with disposable income than with getting income tax-sheltered.

As to the effect on the tax system of making presently nontaxable benefits taxable, it is obvious that this would initially raise revenues collected. The effect would be regressive, since the burden would fall most heavily on middle income wage earners. However, it is to be expected that such wage earners would seek to restore their purchasing power through seeking larger wage increases than would otherwise be the case. To the extent that this succeeded, the tax on benefits would have the same effect on available corporate funds as would an increase in the corporation tax rates. Taxing benefits not only runs counter to present benefit policies, but also has as its main advantage the possibility of getting revenues which would otherwise come from a tax increase, without actually enacting any increase in the tax rates. Higher taxes are higher taxes, however derived; taxing of benefits merely makes the employer community, to some extent, the culprit, rather than the taxing authority.

These observations apply equally to FICA taxes. Why disturb the private insurance system which has brought health and/or life insurance to so much of the work force? If additional funds are needed, a change on the rate would have the same effect as a change in the base. From the employer standpoint of those paying half of the FICA tax on wages in employment, there is no advantage to paying a lower rate on a higher base if the total tax will be designed to come out the same.

The effect of capping tax deferred amounts would be largely cosmetic. It gives the appearance of trying to prevent high income taxpayers from getting a disproportionate break. However, the total revenues which would be raised is not really that great, unless the cap reached down to a figure that affects many, many upper middle income taxpayers. That would be counterproductive to any attempt to make the change get broad based support.

As to the question of whether federally funded social programs would be necessary if employers didn't provide fringe benefits, I think the record is clear. Even in such areas where benefits are provided by employers, as in the private pension system, there has (beginning with ERISA and continuing with other legislation) been increasing limitations on what can and cannot be done. Unfortunately, most of these relate to the question of how to prevent abuses, rather than to the positive aspects of what things of highest general value should be achieved. The items of greatest importance will not be the same for all employee groups, depending on industry, average age, and so on. The present private sector system offers both employees and employers the greatest opportunity to arrive at the most suitable benefits to a given situation. On a more general level, one need only look outside the United States to determine if government programs at some level would be required. Most, if not all, European and Latin American countries have elaborate social payment systems, including all of the major European industrialized societies. The only reason similar systems are not found in this country, in my opinion, is because they are not perceived as being needed, because so many people are covered for various benefits through the existing employer-financed plans.

I trust that these observations will be of assistance to you in reviewing the alternatives.

Respectfully submitted.

WILLIAM H. DUNSTONE, *Vice President.*

STATEMENT OF RONALD D. PEARSON, PRESIDENT AND CHIEF OPERATING OFFICER, HY-VEE FOOD STORES, INC., CHARITON, IA

I'm Ron Pearson, President and Chief Operating Officer of Hy-Vee Food Stores, Inc., Chariton, Iowa. We are an Iowa based company operating 134 supermarkets and 19 drugstores, 153 retail units. We operate in six states—Iowa Missouri, Minnesota, Illinois, Nebraska and South Dakota. Hy-Vee has been in business for 53 years; last year's sales were $1,100,000,000. At fiscal year end we employed 13,505 employees; 62 percent were parttime of which many are highschool or college students.

We are a privately held company, employee owned, with the largest stockholder having no more than 14 percent of the stock.

I'm here today to comment on capital accumulation through profit sharing. Hy-Vee has both a salary bonus system based on individual profit center results and an employee profit sharing trust. With both of these systems we like to think we're a very employee benefit oriented company.

We would like to give some information about our employee trust. We designed the employee trust to allow our employees to share the company profits, building more job satisfaction. Also the trust is to cover retirement benefits, if the employee wishes catastrophic medical expenses not covered by insurance, and dependent education in case of parent hardship.

First, some facts about our profit sharing trust plan. At fiscal year end 6,790 employees were participants, 85.15 percent between the ages of 19 and 44; 15.73 percent between 45 and 70 years of age and .12 percent over 70 years. Out of all these participants 69.13 percent earned less than $20,000 per year; 81 percent earned less than $25,000 and over 98 percent earned less than $50,000 per year (table is attached showing details).

Additional details about our plans: We started our plan in 1960 with a company contribution of $127,606.00 and have now grown to a total value of participants' equity of $75,675,285.00. The plan has grown through healthy company contributions, forfeitures, and a good earnings record (table attached showing details).

We felt three things were important for our employees when we were designing our profit sharing plan:

(1) How soon you can get in:

(2) How long it takes to be 100 percent vested; and

(3) How much you get.

Hy-Vee has elected to make participants eligible at age 19; thus allowing many of our parttimers to accumulate some capital while in school. We have also elected to fully vest a participant after ten years by "graded vesting" and have a graduated scale for vesting between two years and ten years, i.e., five years 40 percent, six years 50 percent, nine years 80 percent, ten years 100 percent.

We have also elected to establish a fixed formula for company contributions rather than have the Board of Directors determine the amount each year. We have averaged approximately 26 percent of pretax company profits contributed to the trust over the past several years.

Why is this data useful to you? We think our plan demonstrates that rank and file workers, including our 200 union employees, are provided outstanding benefits. Also the plan covers predominately low and middle income workers; it is ostensibly not "top heavy." I would like to give you some of the examples of some of the employees who have accumulated capital through this plan.

(1) Employee No. 1—Knoxville, Iowa, parttime employee; started 1977 at age 16; terminated six years later at age 23 after completing college. He accumulated vested capital of $1,488.37.

(2) Employee No. 2—Marshalltown, Iowa, parttime employee; started in 1972 at age 19; terminated twelve years later. She was 100 percent vested; she wanted to spend more time with her family. Her trust account balance was $11,952.54.

(3) Employee No. 3—Clarinda, Iowa, started at age 26, a full time grocery employee; deceased June, 1984, at age 57; 100 percent vested; trust account to his wife of $48,851.40.

(4) Employee No. 4—Chariton, Iowa, full time truck driver; started at age 19; deceased March, 1984, age 53; vested 100 percent; trust account to his wife of $83,449.52.

(5) Employee No. 5—Albia, Iowa; employed June, 1940, at age 20; retired in 1983 at age 64; full time grocery employee; trust account balance of $50,549.88.

(6) Employee No. 6—Sioux Falls, South Dakota, employed June, 1977; age 16; parttime clerk; terminated in March, 1984; vested trust account balance $1,938.12.

(7) Employee No. 7—Marion, Iowa; employed August, 1977; age 16; parttime clerk; terminated March, 1984; vested trust account balance $2,148.87.

(8) Employee No. 8—Trenton, Missouri; employed May, 1967; Age 47; full time grocery clerk; retired January, 1984; vested trust account balance of $38,303.26.

Our plan was designed to help the employees accumulate capital, whether it be a parttime student or a long time retiree. We believe that any changes which are made to disturb this accumulation will not be in the best interest of the rank and file employees of Hy-Vee and may cause them to look to the government for more of their needs.

TABLE 1.—EMPLOYEES' TRUST, 1983

	1983 Participants				
	Full time	Regular time	Part time	Total employees	Percent to total
Age group:					
0–18	0	0	0	0	0
19–44	2,872	1,031	1,811	5,714	84.15
45–70	702	235	131	1,068	15.73
Over 70	2	0	6	8	.12
Total	3,576	1,266	1,948	6,790	100.00
Wage group:					
0 to $5,000	6	23	462	491	7.23
$5,000 to 10,000	124	686	1,405	2,215	32.62
$10,000 to 15,000	517	493	76	1,086	16.00
$15,000 to 20,000	839	58	5	902	13.28
$20,000 to 25,000	787	6	0	793	11.68
$25,000 to 30,000	587	0	0	587	8.65
$30,000 to 35,000	389	0	0	389	5.73
$35,000 to 40,000	138	0	0	138	2.03
$40,000 to 45,000	43	0	0	43	.63
$45,000 to 50,000	28	0	0	28	.41
$50,000 to plus	118	0	0	118	1.74
Total	3,576	1,266	1,948	6,790	100.00

TABLE 2.—EMPLOYEES' TRUST, 1983

Fiscal year	Total part	Company contribution	Percent of pre-tax profit	Percentage for distribution		
				Company contribution percent of wages	Forfeitures	Earnings percent
1960	561	127,606	16.383	3.6216989	0	.6514429
1961	654	124,188	15.756	2.9999400	5.7773930	4.6773020
1962	738	219,013	19.569	4.9065823	7.9091210	(11.1047078)
1963	827	414,959	25.000	7.6603310	4.9749879	9.0212214
1964	941	476,785	25.000	7.7313399	4.4422754	6.8161863
1965	1,024	558,811	25.000	8.4152086	3.2570834	8.7542446
1966	1,101	675,509	25.000	8.7462498	4.1579145	7.7548308
1967	1,206	695,064	25.000	7.9638827	3.5774660	12.9451829
1968	1,291	548,542	20.669	5.8996191	2.5204067	8.8470066
1969	1,338	900,337	25.000	8.6607828	3.2026641	6.0150168
1970	1,568	1,010,975	25.000	7.6769084	2.4799288	6.7975835
1971	1,827	1,047,413	23.651	6.4283721	1.7636118	10.4075341
1972	2,007	1,298,239	25.000	6.9681312	3.1065323	8.2636359
1973	2,125	1,623,933	25.000	7.8461822	2.6635361	7.3930474
1974	2,287	2,276,433	25.000	8.8340190	2.7051493	(1.5934195)
1975	2,515	2,614,433	25.000	8.3029266	1.9216305	13.3010669
1976	2,713	3,447,566	25.000	9.0131974	2.5289300	16.1065776
1977	3,620	3,222,987	25.000	6.9390049	.7271988	9.8795616
1978	4,098	4,024,645	25.000	7.1723166	.7735060	9.9662529
1979	4,584	4,394,230	25.000	6.3896294	.7494020	9.3887776
1980	5,081	4,735,510	25.000	5.9541113	.6340154	7.7457876
1981	5,444	5,643,060	25.000	6.2359841	.6385828	3.6703072
1982	6,156	5,141,420	24.126	4.9050808	.5563821	17.1789124
1983	6,790	5,414,405	24.101	4.7045339	.5539783	14.3021840

STATEMENT OF SOPHIE M. KORCZYK, PH.D.,* ALEXANDRIA, VA

SUMMARY

Mr. Chairman, I am pleased to submit this statement on tax incentives for pensions and flexible benefits programs. Tax provisions governing pensions and flexible compensation plans have figured prominently in Congressional debates over the last three tax bills.

What does pension policy cost?

Tax expenditures are commonly used in public policy debates as a measure of the social cost of federal pension policy. There is wide disagreement, however about the proper way to measure these costs and about who benefits from the incentives provided in these provisions. Measured using the Treasury's approach, about $0.83 out of every tax-deferred dollar appears to be lost to the Treasury. Such estimates overstate the amount of revenue lost due to such provisions, however. Because today's pension-plan participants will have higher retirement incomes than today's retirees, they will pay more taxes in retirement. Over their lifetimes, those employees now at the beginning of their pension careers will repay all but $0.25 to $0.40 of every tax-deferred dollar.

Even this more realistic lifetime measure of tax expenditures probably still overstates the revenue costs of pension-related tax policy. It ignores the availability of other tax-favored investment vehicles that could be used for retirement saving in place of employer pensions as well as the costs of relying on the taxpayer as the sole guarantor of retirement incomes.

Who receives employee benefits?

The expansion of employee benefits has primarily helped the middle income worker. Among employees who were covered by pensions in 1983, nearly 28 million (or 59.0 percent) earned less than $20,000. Among employed persons with employer-provided health coverage 83.7 million (or 74.3 percent) earned less than $20,000, and 23.2 percent earned between $20,000 and $50,000. Fewer than 3 percent of pension and health insurance participants earn more than $50,000.

Flexible compensation plans

The labor force is changing rapidly. Flexible compensation plans have emerged as some employers' effort to respond to the needs of a diverse work force without adding to compensation costs to accommodate each additional group. Most flexible compensation plans allow employees to trade benefits in one area for increases in other benefits. A two-earner couple, for example, can trade redundant health coverage for other benefits such as dependent care, increased life insurance, or added vacation time.

Employers with flexible compensation plans have found that the ability to choose increases employees' satisfaction with their benefits even when the dollar value of the benefits package is unchanged. The ability of employers and employees to use flexible compensation to contain benefit cost growth suggests that these plans can have important macroeconomic effects by stabilizing benefit growth and labor costs.

Recent legislative actions and prospects for the future

Employee benefits issues have played a major role in recent tax policy debates. For example, in the Tax Reform Act of 1984, the Congress made significant changes in at least sixteen areas of employee benefits. The importance of employee benefits in tax policy promises to continue as the Congress tries to deal with projected federal deficits. Both the Congress and the Administration have expressed considerable interest in basic reform of the personal income tax.

In general, basic tax reform proposals would lower marginal tax rates and expand the income tax base. Basic tax reform proposals offer ways to restructure—not lower—the nation's tax bill. Three recent legislative proposals illustrate some of the tradeoffs in basic tax reform.

Comprehensive Income Tax.—Senator Bill Bradley (D-NJ) and Representative Richard Gephardt (D-MO) have introduced a comprehensive income tax proposal (S. 1421/H.R. 3271). It would raise the same amount of revenue as current law by using only a three bracket tax-rate structure: 14, 26, and 30 percent. All employer contributions for benefits other than pensions would be included in the employee's taxable income. The Section 415 limits on pension benefits and contributions would be made much more restrictive than under current law.

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*Sophie Korczyk earned her Ph.D. in economics from Washington University (St. Louis). Dr. Korczyk is presently a research associate at the Employee Benefit Research Institute. Her previous positions include appointments at the Congressional Budget Office and universith teaching and research positions. Portions of this statement are based on Sophie M. Korczyk, Retirement Security and Tax Policy (Washington, D.C.: EBRI, forthcoming).

Senator Mark Hatfield (R-OR) has also introduced a comprehensive tax proposal (S. 2158). The Hatfield proposal would retain current-law treatment for employer-provided pensions, but all other employer contributions for benefits would be included in taxable income. There would be six tax brackets, ranging from 6 percent to 20 percent.

Consumption Tax.—Senator Dennis DeConcini (D-AZ) has introduced a consumption tax proposal (S. 557). Under this proposal, all income other than that used for investment would be taxed at a marginal rate of 19 percent. This tax structure would be financed by eliminating nearly all current law tax preferences. Contributions and benefits in retirement-income programs would retain their current tax-law treatment. The employer's contribution for health, welfare, and "fringe" benefits, however, would no longer be tax deductible as an employer compensation expense.

All three legislative proposals, though they are based on different tax principles, would eliminate tax preferences for most employer-provided benefits. Employer contributions for nonpension benefits would be treated as taxable income.

CONCLUSIONS

We ask, Mr. Chairman, that the Congress recognize how much it has already achieved in safeguarding the economic security of the American worker and that it renew its commitment to encouraging private provision for economic security.

STATEMENT

Mr. Chairman, I am pleased to submit this statement on tax incentives for pensions and flexible benefits programs. Tax provisions governing pensions and flexible compensation plans have figured prominently in Congressional debates over the last three tax bills. In my statement today, I will address the following questions:

What is the revenue cost of pensions and flexible benefits plans?

Who receives these tax benefits?

What does society get for the foregone revenue?

Are tax incentives more effective or less effective in achieving certain goals than other policy devices aimed at the same goals?

What are the implications for upcoming policy debates?

Trends in employee benefits

Employer contributions for employee benefits have increased steadily as a share of compensation over the last thirty years. According to Department of Commerce estimates, cash outlays for employee benefits beyond wages and salaries have grown from 4.9 percent of total compensation in 1950 to 15.8 percent in 1982. Over a third of this amount finances employer-sponsored pension plans. Pension contributions increased from 1.8 percent of employee compensation in 1950 to 5.3 percent in 1982. This growth appears to be slowing, however. Between 1980 and 1982, for example, employee benefits grew 1.6 percent annually as a share of compensation, compared with an annual rate of over 4 percent between 1970 and 19780.

The tax-favored treatment of qualified pensions predates even the establishment of the Social Security system in 1935. Statutes enacted in 1921 and later, covering income from trusts and pension plans, were designed to encourage the expansion of pension coverage and increased saving levels and to provide a private soruce of retirement security. The tax treatment accorded more recently developed retirement and capital accumulation vehicles such as individual retirement accounts (IRAs), simplified employee pension plans (SEPs), section 401(k) plans, and qualified voluntary employee contributions (QVESs) indicates continued Congressional interest in increasing voluntary individual retirement savings.

The federal tax system is the most important factor influencing benefit growth. The tax code makes benefits cost-effective as compensation and encourages the broad coverage of employees. The tax code makes benefits cost-effective by providing a tax deduction for employers and preferential tax treatment for employees. As a result, a dollar in benefits may be worth more to the employee than a dollar in cash wages.

The tax code encourage employers to extend their benefit coverage to lower- and moderate-income employees. The preferential tax treatment accorded benefits is contingent upon compliance with the tax code's nondiscrimination provisions governing coverage of the employer's work force.

Historically, the tax code has also worked with inflation to encourage benefit growth as protection against inflation-driven increases in real marginal tax rates. During the past twenty years, inflation has pushed most taxpayer into higher marginal tax brackets, despite legislation lowering nominal tax rates for the different income levels. This "bracket creep," the gradual increase in real marginal tax rates, has prompted the use of noncash benefits to stem the erosion of real income. Up to 30 percent of the benefit growth over this twenty-five period may be attributed to attempts to alleviate inflation's impact on employee compensation.

While the tax code is a major factor encouraging benefit growth it is not the only factor. Employee compensation also depends on income growth, employer cost considerations, and employer and employee preferences.

What does pension policy cost?

Tax expenditures are commonly used in public debates as a measure of the social cost of federal pension policy. The Treasury estimates that pension-related tax provisions cost the federal government over $50 billion each year in lost revenues. Persistent federal deficits have called attention to Internal Revenue Code provisions that appear to subsidize select groups of taxpayers.

There is wide disagreement, however about the proper way to measure these costs and about who benefits from the incentives provided in these provisions. Tax-expenditure measures used in the federal budget process are calculated on a cash-flow or cross-sectional basis, with the amount of the taxes deferred by current pension plan participants offset against the amount of taxes paid by current beneficiaries. Measured this way, about $0.83 out of ever tax-deferred dollars appears to be lost to the Treasury (see table 1). Such estimates overstate the amount of revenue lost due to such provisions, however. Because today's pension-plan participants will have higher retirement incomes than today's retirees, they will pay more taxes in retirement. Over their lifetimes, those employees now at the beginning of their pension careers will repay all but $0.25 to $0.40 of every tax-deferred dollar. As the pension system matures, the numbers and income levels of pension-plan participants and retirees will differ less than they do today. As a result, in the future, pension-related tax expenditures measured using the Treasury's approach will be much closer to lifetime estimates.[1]

TABLE 1.—HOW MUCH OF PENSION-RELATED TAX DEFERRALS IS LOST TO THE TREASURY?

[In percent]

Method used	Taxes lost	Taxes deferred
Treasury method	83	0
Lifetime method:		
Nominal dollars [1]	14	86
Real dollars [2]	28	72
Discounted for interest: [3]		
At pension rate	40	60
At federal rate	36	64

[1] Before adjusting for inflation.
[2] After adjusting for inflation.
[3] Interest rate used to discount taxes paid in retirement to the year of retirement.

Source: Sophie M. Korczyk, Retirement Security and Tax Policy (Washington, D.C.: EBRI, forthcoming).

Even this more realistic lifetime measure of tax expenditures probably still overstates the revenue costs of pension-related tax policy. Taxpayers have access to many other tax-favored investment vehicles that could be used for retirement saving in place of employer pensions. In the absence of tax provisions favoring pensions, taxpayers would probably make more use of these vehicles. This would increase the revenue loss attributable to these alternative investments.

Tax expenditure statistics are also misleading because they imply that only advance-funded plans impose social costs. Tax deferrals are measured only on contributions and earnings actually received by plans, which means that a pension plan must be advance-funded to result in tax expenditures. The Employee Retirement Income Security Act of 1974 (ERISA) established minimum funding standards for private-employer defined-benefit plans, enhancing benefit security. In contrast, the Civil Service Retirement System (CSRS) and the Military Retirement System (MRS), the two major federal retirement plans, have little impact on tax expenditures because they are largely unfunded. Underfunded or unfunded plans, however, can cost the taxpayer much more in the long run. In sum, pension-related tax policy is not as costly as available revenue-lost estimates would suggest.

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[1] For further analysis of these issues, see Sophie M. Korczyk, Retirement Security and Tax Policy (Washington, D.C.: EBRI, fortchcoming). See also Issue Brief "Pension-Related Tax Benefits," no. 25 (December 1983) and Issue Brief "Employee Benefits and the 1985 Reagan Budget," no. 27 (February 1984).

Who receives employee benefits?

The expansion of employee benefits has primarily helped the middle income worker. Among employees who were covered by pensions in 1983, nearly 28 million (or 59.0 percent) earned less than $20,000 (Table 2). Among employed persons with employer-provided health coverage 83.7 million (or 74.3 percent) earned less than $20,000, and 23.2 percent earned between $20,000 and $50,000. Fewer than 3 percent of pension and health insurance participants earn more than $50,000.

TABLE 2.—DISTRIBUTION OF EMPLOYEES WITH PENSION AND HEALTH COVERAGE BY EARNINGS

Earnings	Employees with pension coverage, 1983		Employees with health coverage, 1983	
	Total (in millions)	Percent	Total (in millions)	Percent
Less than $20,000	27.9	59.0	83.7	74.3
$20,000 to $49,999	18.1	38.0	26.2	23.2
$50,000 and over	1.4	2.9	2.7	2.4
Total [1]	47.4	100.0	73.0	100.0

[1] Detail may not add to totals due to rounding. Totals include only those health and pension plan participants who reported their earnings in the Survey. When those not reporting their earnings are added, coverage totals are higher.

Source: EBRI tabulations of U.S. Census Bureau Current Population Survey, 1983 and EBRI–HHS Current Population Survey Pension Supplement.

The distribution of pension-related tax benefits among income groups reflects the distribution of coverage and participation. The largest share of lifetime pension-related tax benefits accrues to middle-income employees. In 1979, 34 percent of employees aged 25 to 34 earned between $20,000 and $50,000. These employees will receive 53 percent of the group's pension-related tax benefits (table 3). Those employees age 25 to 34 who earned $20,000 or less will receive 24 percent of their group's lifetime pension-related tax benefits, while 22 percent will go to those earning over $50,000.

TABLE 3.—NET LIFETIME PENSION-RELATED TAX BENEFIT SHARES AMONG EMPLOYEES AGED 25 TO 34

Income [1]	All persons (percent)	Pension participants (percent) [2]	Lifetime tax shares by income class [3] (percent)	Lifetime pension benefit tax shares by income class (percent)
$20,000 or less	61	53	42	24
$20,001 to $50,000	34	41	42	53
$50,001 or more	5	6	16	22

[1] Total 1979 income in 1983 dollars.

[2] Includes not only those who were pension participants in 1979, but also those in this age group who are projected to acquire pension coverage later in their careers.

[3] The share of lifetime taxes paid by those with base-year incomes below $50,000 is higher than their share of current-year taxes, because their lifetime incomes are higher than their current-year incomes. In 1982, taxpayers with incomes over $50,000 paid 35.4 percent of total income taxes. U.S. Department of the Treasury, Internal Revenue Service, Statistics of Income Builletin, Winter 1983–1984 (Washington, D.C.: Internal Revenue Service, 1984), p. 20.

Source: EBRI calculations based on PRISM simulation results.

Employee benefits are now a mainstay of the middle-income worker's income security, providing hazard protection as well as building assets. As much as a fifth of all spending on health care is now made through employer-sponsored plans.[2] Pensions also result in a progressive redistribution of wealth that favors those at the lower end of the income scale who do not tend to save much out of current income.

This redistribution can be demonstrated by comparing data on pension coverage and income from savings as reported in the 1983 Health and Human Services (HHS) and Employee Benefit Research Institute (EBRI) Current Population Survey (CPS) Pension Supplement, the best available source of information on pension coverage. Direct information on savings would be preferable to the data on income from savings, but it is not available on a current basis.

Accumulated pension benefits constitute the major form of savings for more than half of all persons with pension coverage. According to the CPS, more than 40 percent of the labor force reported no savings income in 1983 (table 4). This group's average income was $9,651, just under half the average income of those reporting some asset income. Some 55 million workers, including almost half of the group reporting little or no savings income on the CPS, were covered by employer pensions in 1983. Pensions thus constituted a net increase in savings for these workers. Assessments of pension-related tax policies should consider the net increase and redistribution of wealth that results from expanded pension coverage.

TABLE 4.—SAVINGS, PENSION COVERAGE, AND INCOME, 1983

Savings status [1]	Employees covered [2]		Employees not covered		Average annual income	
	(millions)	(percent)	(millions)	(percent)	(dollars)	(percent)
No savings	18.2	19.0	20.6	21.5	$9,661	40.5
Some savings [3]	36.9	38.4	20.3	21.1	19,209	59.5
Total	55.1	57.4	40.9	42.6	15,338	100.0

[1] Individuals are classified as having some savings or no savings based on whether or not they reported any asset income in response to the survey questions. Asset income includes interest, dividends, rents, and royalties.

[2] Coverage refers to public- and private-sector pension plans and includes holders of IRA or Keogh accounts.

[3] Includes individuals reporting negative asset income (i.e., decreases in asset values).

Source: EBRI calculations based on preliminary data from the Bureau of the Census, Current Population Survey (May 1983).

What does society get in return?

Tax benefits are not the only advantage received by pension participants. Whatever the revenue cost of the pension-related tax-code provisions, sould retirement policy design requires that this cost be measured against the social benefit of increased savings and higher benefit levels.

Increased savings.—Pensions both increase and reallocate total savings. If pension contributions were received as cash income, total saving would decrease. The drop, moreover, would be relatively greater among lower-and moderate-income employees. While nonpension saving is concentrated among relatively high-income individuals, pensions are distributed broadly among income groups.

Pensions also change the distribution of saving among investment vehicles. Nonpension saving consist primarily of liquid saving deposits and investments in owner-occupied homes or other consumer durables. Pension funds, in contrast, are invested in securities that finance productive capacity and employment. Pension funds have grown to be the single largest supplier of investment funds to financial markets. At a time when unmet capital financing needs are emerging throughout the economy, the fact that pension funds provide long-term capital gives them an important role in economic policy.

Increased retirement income.—The availability of a pension often means the difference between subsistence and the ability to maintain pre-retirement living standards in retirement. Recent EBRI research projects that over the next forty years real retirement incomes will more than double. The average annual retirement income for those reaching age sixty-five in the 1980s is projected to be $13,376 per household in 1983 dollars. It is expected to increase to $26,802 for those retiring between 2010 and 1019.[3] Average employer pension benefits will increase from $5,315 for those retiring in the 1980s to $12,417 for those retiring between 2010 and 2019. The proportion of new retiree households receiving pension income will grow from 37 percent in the 1980s to 71 percent by 2019.[4]

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[2] Unpublished estimate, EBRI.

[3] Sylvester J. Schieber, *Social Security Perspective on Preserving the System* (Washington, D.C.: EBRI, 1982), p. 100.

Tax payments by retirees will reflect this income growth. Pension beneficiaries retiring in the 1980s will pay an average of $15,808 in taxes (1983 dollars) on their benefits over the course of their retirement.[5] Pension beneficiaries retiring between 2010 and 2019, in contrast, will pay an average of $44,672 in taxes (1983 dollars) on pension benefits during their retirement.

Retirees not only receive larger retirement incomes as a result of employer pensions, but their benefits are more secure due to legally mandated advance funding. This security is all the more important as debates over the fiscal stability of the Social Security system continue. Social Security benefits and employer pension benefits complement each other. As pension benefits increase, Social Security benefits become a smaller share of retirement income. If public policy continues to encourage increased pension coverage and benefit levels, the pension system could reduce the pressure for ever-increasing Social Security benefits.

Alternative wasys to accomplish the goals of pension policy

Some have suggested that the goals of employer pensions should be accomplished using other policy approaches. Two of the alternatives frequently suggested are expanding the allowable deductions for individual retirement accounts (IRAs) and increasing benefits under the Social Security program.

Employer-provided pension coverage is more widespread than IRA participation. Preliminary EBRI results from the HHS-EBRI CPS Pesnion Supplement suggest that middle- and higher-income individual were the primary beneficiaries of the broadening of IRA eligibility. An estimated 31 percent of households reporting incomes of $15,000 or higher hold IRS accounts, compared with 9 percent of households with incomes below $15,000. By comparison, almost five times as many workers earning less than $15,000—43 percent—are covered by employer pensions. Since IRAs by their very definition do not have any nondiscrimination standards protecting the interests of those at the lower end of the income scale, expanding IRA limits would provide nothing for these households.

Expanding the Social Security program at the expense of employer pensions would present a different set of problems. Most researchers agree that the Social Security payroll tax as it is currently constituted is regressive. The American people would almost surely demand that the tax be restructured if it were to increase significantly. It is unlikely, furthermore, that the federal budget system would be able to tolerate the spending and tax increases that would be necessary if Social Security were to become the sole guarantor of post-retirement living standards across the income spectrum.

Flexible compensation plans

The labor force is changing rapidly. Census data show that over the last decade, the proportion of single-adult households with children increased by one-third. Over half of married women are now in the labor force. Single-adult and two-earner household have different benefit needs then the traditional single-earner, two-parent family. Many of these households need child care, and may have different health- and life-insurance needs than either traditional families or single persons.

Flexible compensation plans have emerged as some employers' effort to respond to the needs of a diverse work force without adding to compensation costs to accommodate each additional group.[6] Most flexible compensation plans allow employees to trade benefits in one area for increases in other benefits. A two-earner couple, for example, can trade redundant health coverage for other benefits such as dependent care, increased life insurance, or added vacation time.

Flexible compensation plans are a relatively new development in employee benefits that is now becoming fully delineated. While some flexible compensation plans existed as early as 1972, Section 125 of the Internal Revenue Code was enacted in 1978 to extend the statutory protection from taxation that applies to other employee benefits to plans that give employees some choice over the mix of employer-provided benefits they receive. The statutory authority for these plans has been in place for six years, but the Administration issued preliminary regulations governing the implementation of these plans in May of this year.

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[4] Ibid., p. 90.

[5] Unpublished EBRI tabulations of PRISM simulation results.

[6] For background on flexible benefits plans and their relevance to changing employee needs, see Dallas L. Salisbury, ed., America in Transition: Implications for Employee Benefits (Washington, D.C.: EBRI, 1982); Issue Brief "Flexible Compensation and Public Policy," no. 24; and Chapter XXII, "Flexible Compensation Plans" in Fundamentals of Employee Benefit Programs (Washington, D.C.: EBRI, 1983).

Cafeteria plans, as they are also called, have grown considerably since they were first authorized. In a recent variation of these plans, about a third contain reimbursement accounts or flexible spending accounts (FSAs). FSAs allow employees to pay for unreimbursed medical expenses and some other benefits with pre-tax dollars. Such accounts are used to cushion the impact of a change in the employer's health insurance plan that might otherwise be seen as a benefit takeback. An estimated 1.5 million employees now participate in plans with flexible spending accounts alone, and as many as five million may be participating in cafeteria plans as a whole.

The Congress and the Administration have recently become concerned about the potential revenue impacts of flexible compensation programs that incorporate FSAs. Estimates of the federal revenue effects of FSAs differ widely. This divergence of estimates stems from differing assumptions about the design of these programs, distribution of participants among various types of programs, and the elections that participants make. FSAs instituted in conjunction with a leaner health plan probably contribute to slowing down the growth of benefits as a share of compensation because health care costs are the fastest-growing employee benefit.

Employers with flexible compensation plans have found that the ability to choose increases employees' satisfaction with their benefits even when the dollar value of the benefits package is unchanged. This can reduce the pressure on employers to increase benefits to maintain a competitive compensation package. The ability of employers and employees to use flexible compensation to contain benefit cost growth suggests that these plans can have important macroeconomic effects by stabilizing benefit growth and labor costs. Stabilizing benefit growth will keep wages and salaries a constant share of total compensation. This would mean that a constant share of total compensation would be received in a taxable form. Stabilizing labor costs, in turn, can contribute to reduce production costs throughout the economy.

Recent legislative actions and prospects for the future

Employee benefits issues have played a major role in recent tax policy debates. For example, in the Tax Reform Act of 1984, the Congress made significant changes in at least sixteen areas of employee benefits. These included: employee stock ownership plans; cost-of-living adjustments in pension plan limitations; individual retirement accounts; group term life insurance purchased for employees; funded welfare benefit plans; unfunded deferred benefits; distributions in qualified pension plans; top-heavy plans; estate-tax treatment of qualified pension plan benefits; pension plan rules for affiliated service groups, employee leasing arrangements, and collective bargaining agreements; cash or deferred arrangements; treatment of certain medical and other benefits under section 415; the statutory treatment of certain employee benefits; pension-plan terminations; voluntary employee benefits associations; and rules governing multiemployer plans.

The importance of employee benefits in tax policy promises to continue as the Congress tries to deal with projected federal deficits. Both the Congress and the Administration have expressed considerable interest in basic reform of the personal income tax. At least a dozen basic tax reform proposals were introduced in the 97th Congress and more were introduced in the 98th Congress. President Reagan has also asked that the Treasury department analyze basic tax reform options and prepare a report by December 1984.

In general, basic tax reform proposals would lower marginal tax rates and expand the income tax base.[7] Basic tax reform proposals offer ways to restructure—not lower—the nation's tax bill. Most proposals do not envision widespread tax cuts, but would instead change the distribution of tax liability among individuals. This would be done by expanding the tax base to eliminate many tax preferences in current law, including those governing the tax treatment of employee benefits. With a broader tax base, marginal tax rates on income could be lowered.

At the heart of basic tax reform movement is the widespread belief that the tax system is unfair and inefficient. The proliferation of tax preferences can mean that differences in tax liability among individuals stem as much from the ability to manipulate the tax system as from differences in ability to pay. Energy is spent utilizing tax preferences and loopholes that could be spent on more productive activities. High marginal tax rates encourage taxpayers to seek out tax-favored sources of income—capital gains, for example—and tax-favored uses of income, such as housing. As a result, investment and other economic decisions are often driven by tax needs as much as by economic returns and productivity considerations. An advantage often cited for expanding the tax base and reducing marginal tax rates is eliminating this effort by making the tax code more neutral in economic decisions.

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[7] For a detailed discussion of the mechanics of basic tax reform, see EBRI *Issue Brief* "Basic Tax Reform: Implications for Employee Benefits," no. 28 (March 1984).

The arguments for broadening the tax base have attracted a wide range of political support. Conservatives support broadening the tax base as a way of eliminating the income-earning disincentives and market interference of high marginal tax rates. Liberals support broadening the tax base as a way of eliminating tax-code provisions perceived to benefit primarily the rich.

Recent tax-reform debates have centered around the comprehensive income tax and the consumption tax.[8] The basic premise behind the comprehensive income tax is that individuals should be taxed on the value of what they produce, as represented by income. A comprehensive tax attempts to tax both actual and imputed income. Comprehensive income tax proposals include in taxable income not only cash wages but also all other items of value received by the employee as compensation.

The basic premise behind the consumption tax is that individuals should be taxed not on the economic value they generate but rather on what they use up—or the share of income that is not saved. The consumption tax would exclude all forms of saving from taxable income until the funds were used for consumption. The consumption tax would tax all employer contributions for benefits that do not result in saving. This includes various employee benefits that provide insurance protection, but does not include pension or capital accumulation plans, since they result in saving.

Three recent legislative proposals implement these principles. These proposals illustrate some of the tradeoffs in basic tax reform. All of them combine tax rate reduction with tax base expansion, with implications for most employee benefits.

Comprehensive income tax

Senator Bill Bradley (D-NJ) and Representative Richard Gephardt (D-MO) have introduced a comprehensive income tax proposal (S. 1421/H.R. 3271). It would raise the same amount of revenue as current law by using only a three bracket tax-rate structure: 14, 26, and 30 percent. The reduced rate structure would be financed by eliminating or cutting back approximately forty current-law tax preferences. Tax preferences that would be retained include deductions for home mortgage interest, charitable deductions, state and local property and income taxes, and some medical and business expenses. All employer contributions for benefits other than pensions would be included in the employee's taxable income. The Section 415 limits on pension benefits and contributions would be made much more restrictive than under current law.

Senator Mark Hatfield (R-OR) has also introduced a comprehensive tax proposal (S.2158). Under this proposal, most deductions, credits, and exemptions would be repealed, and many items currently excluded from adjusted gross income would be included. The Hatfield proposal would retain current-law treatment for employer-provided pensions, but all other employer contributions for benefits would be included in taxable income. There would be six tax brackets, ranging from 6 percent to 20 percent. The current structure of exemptions and deductions would be replaced by five tax credits for the taxpayer, spouse, and dependents; and for portions of charitable contributions, home mortgage interest, taxes paid, and medical expenses.

Consumption tax

Senator Dennis DeConcini (D-AZ) has introduced a consumption tax proposal (S.557) Under this proposal, all income other than that used for investment would be taxed at a marginal rate of 19 percent. This tax structure would be financed by eliminating nearly all current law tax preferences. All income would be taxed once, and as close to the source as possible. Advocates of such a tax structure argue that it would eliminate allowing income to escape taxation entirely, while other income is taxed more than once.

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[8] Both tax systems would require detailed judgments about the treatment of various sources and uses of income. Both would also create some formidable implementation and transition problems. These problems and issues are treated in detail elsewhere. For a discussion of employer pensions in basic tax reform, see Sophie Korczyk, Retirement Security and Tax Policy (Washington, D.C.: EBRI, forthcoming). For a wide-ranging discussion of theoretical and practical issues in basic tax reform, see U.S. Department of the Treasury, Blueprints for Basic Tax Reform (Washington, D.C.: Government Printing Office, 1977).

Contributions and benefits in retirement-income programs would retain their current tax-law treatment. The employer's contribution for health, welfare, and "fringe" benefits, however, would no longer be tax deductible as an employer compensation expense. Employers would not be taxed on the value of employer contributions for nonpension benefits since the employer would already have paid tax on these contributions. Since cash compensation would continue to be a tax-deductible cost of doing business to the employer, the employer would presumbably have an incentive to offer more compensation in cash than in benefit contributions.[9]

Comparing major basic tax reform proposals

All three legislative proposals, though they are based on different tax principles, would result in similar treatment for many benefits. Tax preferences for most employer-provided benefits would be eliminated. Employer contributions for nonpension benefits would be treated as taxable income. Had such a provision been in effect in 1982, an estimated $72.9 billion would have been added to that year's taxable employee compensation (Table 5). Federal tax revenues, as measured by the U.S Treasury's calculations of tax expenditures attributable to these benefits, could have been as much as $19 billion higher, assuming current-law tax rates.[10]

TABLE 5.—EMPLOYER CONTRIBUTIONS AND TREASURY DEPARTMENT TAX EXPENDITURE ESTIMATES FOR SELECTED VOLUNTARY BENEFITS [1]

[In billions of dollars]

Benefit contributions	Employer cost [2] (1982)	Federal tax expenditures (1982)
Health insurance	$65.7	$16.4
Life insurance	7.2	2.0
Accident and disability insurance	NA	.1
Other employer-provided benefits:		
Child care		
Educational aid		
Legal services plans	NA	.6

[1] Voluntary benefits are those not mandated by law. Examples of mandatory benefits are Social Security benefits and unemployment compensation.

[2] Totals cover both private- and public-sector employees.

Sources: Employer cost data from table 6.15 in U.S. Department of Commerce, Survey of Current Business vol. 63, No. 7 (July 1983), p. 74. Tax expenditure data from Executive Office of the President, Office of Management and Budget, The Budget of the United States, fiscal year 1982, Special Analysis G.

The primary differences among these proposals are in their treatment of retirement income programs. The DeConcini and Hatfield proposals would continue the current-law treatment of pensions. The Bradley-Gephardt proposal, however, would impose more restrictive benefit and contribution limits under Section 415 of the Internal Revenue Code. Limits on allowable benefits in defined/benefit plans would be reduced from $90,000 under current law to $60,000; contribution limits in defined-contribution plans would be lowered from $30,000 to $20,000; and indexing of these limits would be eliminated. The immediate effects of this change would be felt primarily by higher-paid persons. The longer-term repercussions could be much broader, however. As many as 20 percent of younger pension participants could be directly affected, and many more could be affected indirectly by the adjustments plan sponsors could be forced to make.[11]

These proposals, therefore, would change the relative attractiveness of cash and benefits as forms of compensation. They would also change the relative attractiveness of various benefits. In general, tax policy under these proposals would continue to provide some encouragement for benefits that constitute capital accumulation, but benefits that provide current protection would be cut back.

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[9] This argument is advanced in Robert E. Hall and Alvin Rabushka, *Low Tax, Simple Tax, Flat Tax* (New York: McGraw-Hill Company, 1983), p. 90.

[10] Actual revenue gained from removing tax preferences for employee benefits would be lower because tax rates would be lower and because employers and employees would change their behavior to avoid taxes.

[11] See Retirement Security and Tax Policy, Chapter VII.

CONCLUSIONS

Critics of employee benefits allege that benefit-related tax provisions are regressive, providing tax shelters for the wealthy and little or no benefits for anyone else. EBRI research, using data collected by the federal government and projections based on these data, shows conclusively that this is not the case. Rather, the distribution of employee benefits follows the overall distribution of income very closely; the middle class gains the most from employee benefits.

There is much unfinished business in employee benefits, however. The recent recession, combined with long-term interindustry shifts in employment, appears to have reduced pension coverage rates from pre-recession levels. While the economy is now recovering, the damage done to benefit coverage levels will take longer to repair. Employers in low-coverage sectors and in small firms will need time and a secure economic evironment to establish employee benefit plans. A secure economic environment means not only a healthy economy but also a stable regulatory environment. A pension plan in particular requires a long term commitment from both the employer and the employee if it is to deliver a meaningful retirement benefit. Employers will not make this commitment if they expect the terms on which it is delivered to change with every change in the political and budgetary environment. Therefore, Mr. Chairman, we ask that the Congress recognize how much it has already achieved in safeguarding the economic security of the American worker and that it renew its commitment to encouraging private provision for economic security.

JENKENS & GILCHRIST,
Dallas, TX, September 17, 1984.

Hon. J.J. PICKLE,
Chairman, Social Security Subcommittee,
Cannon House Office Building, Washington, DC.

Hon. FORTNEY H. STARK,
Chairman, Select Revenue Measures Subcommittee,
Longworth House Office Building, Washington, DC.

GENTLEMAN: In the past six months we have again had extensive legislation adversely affecting employers' ability to provide qualified and nonqualified fringe benefits to employees. The private retirement plans and health and welfare benefits program sector are so material to the overall well-being of our Nation's economy that it never ceases to amaze me how Congress continues to tamper. I know you both recognize that the federal systems of providing pensions (Social Security) and welfare benefits (Medicare and Medicaid) have been wholly inadequate to the task. I need not tell you that the statistics on the diverse coverages that the private sector provides to employees and the effectiveness of such benefit systems show that the private sector clearly out-performs the government in the economic delivery of benefits. I am sure that many of the witnesses that you will have speaking at your hearings will testify to these matters.

What I would like to point out to you, however, is so obvious no one may note or mention it. It came to me last evening while helping my five year old son with his early spelling skills for his kindergarten class. As we sat and looked at his alphabet, it came to me that the myriad of recent (often petty) changes in the law with respect to employee benefit plans of late may well do to the private sector's ability to provide retirement and welfare benefits the same damage as if every six months I were to change alphabets on my son—first English, then Aramaic, then Russian, Chinese, etc., etc. How difficult it would be for him to operate in such a continuously changing environment. Changing "codes" was common during World War II, when good cryptographers were an ally to our government's efforts. What Congress is doing to the private system of delivering employee benefits is akin to crytographic code changes. It can only be that Congress has forgotten that the private sector is not the enemy.

I call upon you to declare a truce in this area, recognize the coincidental harm being done to the private sector, so that the resources of the private sector are not so frequently diverted to the needless expense (tax deductible I might add) of continuously keeping pace with ever-changing Congressional trends. The American people face a serious crisis in the ailing Social Security system, but I suggest you face it head-on and not take down the private security system with it.

Sincerely yours,

GARY B. LAWSON.

Statement of Peter A. Biggins, Director, Personnel Planning, LTV Corp.

My name is Peter A. Biggins. I am Director—Personnel Planning for the LTV Corporation, P.O. Box 225003, Dallas, TX 73265. The purpose of my statement is to set forth LTV's views on the subject of employee benefits. Since January 1, 1983, LTV has been providing certain employees with flexible compensation through a "cafeteria" benefit program, and my statement will focus on this approach to the design of employee benefits.

DEVELOPMENT OF CAFETERIA PLANS

Historically, there was a time when compensation was perfectly flexible. Salary was the only source of compensation. The employee had complete freedom to use it as he or she wished. Both the employer and employee got full value from compensation.

Then, two things happened. First, employers started to provide employee benefits instead of salary. Benefit programs were provided because employers felt a responsibility to take care of employees. Second, governments at various levels started to impose taxes on compensation. In general, however, compensation used directly by employers for benefits was nontaxable. Group benefits were accorded favorable tax treatment to keep government-sponsored social security programs to a minimum and, perhaps, to avoid income measurement problems.

Employer-selected benefit programs flourished and compensation as a whole became inflexible. Without freedom of choice, the mix of benefits became less than optimal for most employees. Compensation dollars produced less than full value for employers and employees.

Inflexible group benefit programs, including employer contributions to government programs, got to be 37% of base pay for larger employers. Despite the magnitude of this extra compensation, it is less than fully appreciated by many employees. Based on a recent survey by Opinion Research Corp., 69% of those surveyed thought their employer spent less than 20% of their pay on benefits. Another 19% just didn't know.

About ten years ago, a few employers started questioning the system. They saw that they were getting less than full value for their compensation dollar because the benefit programs they selected on a group basis were going unrecognized and weren't exactly meeting the needs of individuals in a changing workforce. They wondered whether they could trust their employees to design their own benefits. After holding discussions with groups of employees, they found that their employees wanted and were able to take care of themselves. They realized that their new computers were well-suited to keeping track of employee-chosen benefits and that their employees were willing to interface with their computers. Cautiously, they decided to convert a small part of their inflexible group benefit dollars into a supplemental source of compensation that employees could use individually to buy the benefits that they wanted.

These pioneering employers saw that the tax laws were holding them back. Employee choices had to be limited to just taxable uses or just nontaxable uses. Employees could not choose between taxable and nontaxable uses without rendering the nontaxable uses taxable. In 1978 and 1980, Congress responded to the concerns of these employers by enacting legislation that allowed choice between taxable and nontaxable uses, thereby enabling a quantum leap in the development of cafeteria plans.

The trend toward flexibility is in its infancy. Only a hundred or so employers have converted from inflexible group benefits to a flexible compensation source, and those that have converted no more than about 10% or 20% of their benefit dollars.

There are signs, however, that a major trend is beginning to develop. Employees understand and want choices. Employers are becoming more trusting and willing to let go of their benefit design strings. The experience of the pioneers is very favorable in terms of both employee acceptance and administrative capability.

The purpose of this statement is to describe the LTV cafeteria benefit program and its impact on LTV, LTV employees, and Federal revenues. Before doing so, however, it will be helpful to establish some basic concepts of compensation.

TWO SIDES OF COMPENSATION

There are two sides of compensation, sources and uses. Sources are where the money comes from, and uses are where the money goes. Sources of compensation include base pay, overtime, bonuses, and the dollars spent by an employer on base employee benefits. Uses of compensation include take-home pay, taxes, payroll deductions for optional benefits, and the base benefits purchased with employer dollars. The total of uses equals the total of sources.

To make compensation more flexible, some employers have converted part of one compensation source, base benefit dollars, into a new compensation source that the employee can allocate to a variety of uses. This new source goes by various names: flexible credits, company contributions, benefit bank, supplemental pay, etc.

TAXATION DEPENDENT UPON USE

Compensation sources are taxable or nontaxable according to their use. A use that makes compensation sources taxable is called a taxable use. One that makes compensation sources nontaxblbe is called a nontaxable use. According to current Federal income tax law, compensation uses are divided into nontaxable and taxable uses as follows:

Nontaxable uses.—Health care, Legal services, Day care, Disability income, Employee life insurance up to $50,000, Accident insurance, Pension, Tax-deferred capital accumulation—401(k), and Vacation.

Taxable uses.—Employee life insurance over $50,000, spouse life insurance, IRA capital accumulation (tax-deductible), Regular after-tax capital accumulation, take-home pay, and taxes.

Base benefits provided by employers are of the nontaxable variety with the exception of employee life insurance over $50,000. Optional benefits historically have been of the taxable variety because of the tax laws.

Since the Federal income tax laws were changed in 1978 and 1980, nontaxable benefits retain their tax effectiveness when they are offered as optional benefits, regardless of whether they are offered as an alternative to taxable uses. Before that, benefits that were nontaxable as base benefits became taxable if offered as an option along with taxable benefits and cash uses.

SOCIAL SECURITY TAXATION

Social security taxation is the same as Federal income taxation with one exception. The 1983 social security legislation included tax-deferred capital accumulation in the social security wage base if the employee has an option. From the standpoint of those employers who are adopting the new flexible compensation concept, the 1983 law adds another complexity to an already complex subject. Complexity increases the possibility that employees will misunderstand the program and make mistakes in choosing optional benefits. It also adds to the cost of designing and operating administrative systems.

INFLEXIBILITY COMPENSATION

Flexible compensation is the absence of inflexibilities in sources and uses. There are eight kinds of inflexibility: base benefits, source segregation, limited options, option bundling, benefit maximums, price subsidies, timing restrictions, adverse selection.

Base benefits are inflexible because sources are earmarked for uses. With mandatory group benefit programs, the employer's compensation dollars are automatically spent on specified benefits. This inflexibility can be reduced by converting base benefits into supplemental pay.

Source segregation exists when the source of compensation available for certain uses is restricted. Without the 1978 and 1980 changes in Federal income tax laws, flexible compensation programs could not get rid of source segregation. Supplemental pay, the new source created out of reduction in base benefits, had to be spent on nontaxable uses only. And, base pay had to be spent on taxable uses only (taxable benefits and take-home pay). The tax laws no longer produce this inflexibility.

Limited options occur simply when an employer does not offer the full range of "effective" optional benefits. Optional benefits are effective when, relative to purchase apart from the employer, they have tax advantages, cost less, or can be purchased more conveniently through payroll deduction. Only a few employers offer all such options that are available.

Option bundling is the putting together of two or more options in one option. This is done to simplify the administration and communication of the program and to avoid adverse selection.

Benefit maximums limit flexibility in that an employee cannot purchase as much of an optional benefit as he or she would like. The most common benefit maximums are those imposed by law on nontaxable benefits to limit discrimination in favor of higher-paid employees (health care spending account, nontaxable life insurance, tax-deferred capital accumulation, and IRA). Maximums are also imposed when employers wish to limit overuse of benefits (health care and disability income).

Price subsidies reduce flexibility because, if the price of a benefit is subsidized, the employee feels more compelled to select it. One example is employer matching of employee contributions to a capital accumulation plan. Another is pricing that does not vary by age for an age-related benefit like life insurance. When uses are priced without subsidy, true flexibility is obtained.

Timing restrictions are a form of inflexibility. If the employee cannot change a benefit selection when his or her needs change, then there is inflexibility until the change can be made. Some "flexible" benefit programs operate on an annual basis with no changes allowed during the year. Some timing restrictions are necessary to limit adverse selection of health care, disability income, and life insurance.

Adverse selection occurs with insurance options. Flexibility is diminished when employees can predict the occurrence of the event insured. For example, if eyeglass insurance were offered and employees could preduct their need for eyeglasses, the option price would rise to the actual cost of eyeglasses. Those who do not need eyeglasses would not buy the option. Those who do would buy it. Furthermore, there would be a tendency for the price to rise to the highest cost of eyeglasses as those with lowest cost dropped out and bought eyeglasses cheaper without insurance. This is called adverse selection. It renders this type of "insurance" ineffective as a flexible use. The result is no flexibility. On the other hand, when the occurrence of the insured event is not predictable, there can be no adverse use selection, and flexibility is retained.

Adverse selection can be reduced by packaging the insurance with other uses, by requiring advance selection before the event can be predicted, by requiring evidence of good health, or by subsidizing the price. All these methods of reducing adverse selection, however, create other kinds of inflexibility.

There is no clear-cut definition of flexible compensation. It's a matter of degree. The fewer the inflexibilities, the more flexible the program.

LTV EMPLOYEE BENEFITS

The LTV Corporation is a diversified operating company involved in three basic lines of business—steel, aerospace, defense and energy products.

The company is a primary supplier of steel products to the automotive, appliance and construction industries; missiles, aircraft components, tactical wheeled vehicles and electronics to the defense and commercial aerospace markets; and tubular products, oil field supplies and drilling and production equipment to the petroleum industry.

LTV employs approximately 68,000 employees in the United States. About 13,000 are located in Texas, 24,000 in Ohio, 11,000 in Pennsylvania, 8,000 in Indiana, 5,000 in Illinois and the remainder are scattered throughout many other states. Together with dependents and retirees, over 300,000 Americans are protected by various LTV employee benefits, including pension, profit sharing, savings, health care, life insurance, disability income, vacations, holidays, day care, and legal services. Some of these benefits are nontaxable benefits, and some are taxable. While not all employees have all the benefits, the benefits are available to and used by a broad cross-section of employees, whether they be low-paid or high-paid, female or male, black or white, single or married, old or young. Less than 2% of our employees earn over $50,000 a year. About 70% of our employees have 10 or more years of service and are vested in an LTV pension.

LTV benefit programs have grown primarily as a response to employee needs for (1) income maintenance in the event of retirement, death or disability, (2) protection against unexpected health care costs, and (3) time off for rest and recreation. They are secondarily a response to income tax advantages made available by Congress over the years for social purposes. If the tax advantages had not been made available by Congress, some of the benefit programs would not exist, some would not provide the same level of protections, and some would not cover as many employees.

LTV CAFETERIA PROGRAM

Like the compensation programs of most other companies, the programs at LTV became increasingly inflexible, as monolithic benefit programs grew over the years at a faster pace than direct pay. Today, employee benefit dollars exceed 40% of direct pay.

These employee benefit dollars are a part of LTV's total compensation resources. As an economic entity, LTV is very concerned about maximizing the value of its compensation resources. We believe that employee benefit dollars are better spent if allocated by employees individually to the benefits that they need. We trust our employees' abilities to determine their own needs and to select benefits to meet those needs.

With the changes in the tax laws in 1978 and 1980, LTV has been able to construct a whole new kind of compensation program for its employees. Called "Design Your Benefits," it provides employees with choice by providing two types of benefit programs: Base benefits automatically provided by LTV and optional benefits that employees can select to meet their individual needs.

Supplemental—or extra—pay is provided to employees to help purchase optional benefits or simply to increase their take-home pay. Supplemental pay was created by reducing base benefits from the levels formerly provided by LTV. The pay, whether base or supplemental, that an employee uses to purchase "nontaxable" benefits is nontaxable (tax-free or tax-deferred). The pay used for "taxable" benefits or take-home pay is taxable.

Base benefits still provided by LTV are health care (tax-free), disability income (benefits payments taxable), profit sharing (tax-deferred), retirement income (tax-deferred), and vacations and holidays (taxable). Optional benefits include a benefit bank for health care, day care, and legal services (tax-free); health maintenance organizations (tax-free); supplemental disability protection (benefits payments taxable); life insurance protection for employees (tax-free up to $50,000, taxable over $50,000) and spouses (taxable); accidental death insurance protection for employees (tax-free) and spouses (taxable); capital accumulation under IRS code Section 401(k) (tax-deferred in whole for Federal income tax and earnings only for social security tax); Individual Retirement Account (tax-deferred); after-tax capital accumulation (earnings tax-deferred); and optional vacation (taxable when taken).

Supplemental pay is paid each pay period with base pay. The costs of optional benefits are deducted from pay each pay period. In general, employees can start, stop, or change optional benefit selections at any time.

The new "Design Your Benefits" program began on January 1, 1983, for 6,600 employees in the LTV Aerospace and Defense Company (Vought aero products division and Vought missiles division) and for 300 employees in LTV's corporate headquarters. It began on October 1, 1983 for 5,300 employees in LTV's steel group (former Jones & Laughlin Steel Corporation). It began on July 1, 1984 for 2,000 employees in the LTV Energy Products Company. The program will be introduced elsewhere within LTV in the future.

LTV CAFETERIA RESULTS

We have now had almost two years of experience with "Design Your Benefits" and are confident that it is meeting our expectations. The creation of supplemental pay has shifted an average of 4% of base pay from inflexible base benefit dollars to the new flexible compensation source. The range is from 2% to 9%, depending on age, service, and organizational unit.

That employees reallocated the benefit dollar to better serve their needs is confirmed by a variety of selection results for the Vought divisions:

45% of employees took more life insurance than they had before and 33% took less. Only 22% bought back the same amount.

33% of employees who could buy more vacation than they had before did so. Forty percent of employees who could buy less than they had before did so.

63% of employees who could buy more disability protection than they had before did so. Twenty-one percent who could buy less did so.

Many employees added entirely new protection under "Design Your Benefits" that they did not have under the old program.

63% chose the benefit bank. Practically every participant used it for health care, 11% of participants used it for legal services, and 7% of participants used it for day care. Ninety-one percent received refunds at year-end.

57% chose spouse life insurance.

73% chose employee accident insurance.

50% chose spouse accident insurance.

37% chose tax-deferred capital accumulation.

Some employees even increased their participation in capital accumulation options that existed already in the old program.

Participation in the IRA increased to 31% of employees from 23%.

Participation in the regular after-tax capital accumulation increased to 40% from 31%.

Two out of three employees participate one way or another in the capital accumulation options.

In offering "Design Your Benefits" to employees, we trusted them to assess their own needs and make selections. We tried to keep the program as simple as possible. Seventy-seven percent of the employees thought the program made sense. Seventy-five percent thought the written materials were easy to read.

Almost everyone made use of a programmed-learning workbook that allowed them to calculate their first compensation statement in advance. An extra step had to be added to the workbook for 1984 to deal with difference in Federal income and social security taxation of tax-deferred capital accumulation (Section 401(k)).

The compensation statement is attached to each paycheck the employee receives and shows the employee's base and supplemental pay for the pay period and year to date, the level of optional benefits selected, and the amount of payroll deductions for the period and year to date. The purpose of the statement is to regularly remind the employee of the selections. The employee is free to change optional benefits at any time, subject to health evidence requirements for life insurance and disability protection.

There is no way to prove conclusively that LTV is getting more for its compensation dollar with "Design Your Benefits," but it is our considered judgement that we are getting a lot more not only because employees are better able to allocate our compensation dollar but also because they are actively participating and helping themselves.

The average cost of implementing "Design Your Benefits" is about $75 per employee. As more employees are added to the program, the average cost will decline due to the spreading of developmental costs.

LTV TAX REVENUE EFFECT

There is concern among some observers about a potentially large revenue loss that could occur as a by-product of a possible trend toward programs like "Design Your Benefits" and possible discrimination in favor of higher-paid employees. We would like to take this opportunity to share certain statistics from "Design Your Benefits" that indicate what we believe to be minimal impact on tax revenues to the Federal government.

First, employees are not just grabbing all the nontaxable benefits they can get. In fact, they are actually using far less than the nontaxable benefits they could potentially select. The average annual payroll deduction selected by employees of the Vought divisions for nontaxable optional benefits under Section 125 is $1,168 out of a possible $6,269. Employees are selecting only 19% of the potential nontaxable benefits. The table below shows a summary by type of benefit.

	Annual potential	Annual actual	Percent
Nontaxable benefit option:			
Benefit bank [1]	$5,390	$584	11
Disability income	43	30	70
Employee life insurance	185	165	89
Employee accident insurance	79	56	71
Vacation	572	333	58
Total	6,269	1,168	19

[1] Actual benefit bank usage is $505 for health care, $53 for dependent care and $26 for legal services.

These figures should allay any fears that employees are selecting benefits with the sole objective of avoiding taxable income. It should also be noted that employees are participating equally as much in taxable options. Average annual payroll deductions for other benefits are: employee life insurance over $50,000 ($231), spouse life insurance ($109), spouse accident insurance ($10), and regular after-tax capital accumulation ($818). In addition, the average annual payroll deductions for qualified nontaxable benefit options are as follows: tax-deferred capital accumulation under Section 401(k) ($657) and IRA capital accumulation ($604).

Second, the estimated revenue loss for nontaxable benefits covered by Section 125 is $1 a year per employee. The average nontaxable income per employee per year that is related to the availability of Section 125 is as follows:

	Without section 125	With section 125	Increase or (decrease)
Nontaxable benefits:			
Benefit bank:			
Health care		$505	$505
Day care		53	53
Legal services		26	26
Disability income [1]	$26	30	4
Employee life insurance	185	165	(20)
Employee accident insurance		56	56
Spouse pension [1]	56		(56)
Vacation [1]	319	333	14
Base health insurance	2,363	1,785	(578)
Total	2,949	2,953	4

[1] Excludes that portion of the base benefit that has remained the same.

Based on an assumed marginal tax rate of 35% for Federal income taxes, the estimated annual revenue loss per employee is $1. Practically speaking, there is no revenue loss.

In summary, we believe the experience that LTV has had with flexible benefits indicates that employees in companies like LTV will not substantially erode the income tax base through cafeteria plans allowed under Section 125. We believe that Section 125, including the use of salary reduction, should remain as an integral part of our national tax policy because it enables emplyers to maximize the value of their compensation dollars by allowing employees to choose benefits that meet their needs. We ask that programs like LTV's "Design Your Benefits" be allowed to develop without arbitrary limitations and with uniformity in taxation for Federal income and social security tax purposes.

HEALTH CARE

LTV provides base health care benefits for all employees, retirees and their dependents. To reduce overuse of the health care system, the company has ben replacing its first-dollar insurance plans with a new plan that provides for (1) advance approval of hospitalization and (2) cost sharing for other health care. There is an annual deductible for non-hospital medical expenses equal to 1% of annual base pay, followed by 20% employee co-payments. These co-payments stop, however, when they amount, in a year's time, to 2% of annual base pay. The design savings (about 10%) are passed on to the employees through an addition to supplemental salary. Utilization savings (about 10%) are retained by the company.

The company has not offered optional health insurance plans that have varying degrees of cost sharing for two reaons. First, we wanted to obtain utilization savings for all employees now, not just those who happen to select the options that have a higher degree of cost sharing. Second, we were concerned about the cost of adverse selection. We felt that employees in poorer health would select lower cost sharing and that, no matter where we set the price of the options, we would get "out-selected."

BENEFIT BANK

Redesign of health care benefits has had a major impact on employees because it has shifted risk to them. LTV would probably not have made such a drastic change had it not been for the availability of a "benefit bank". with a benefit bank, the employee may make deposits to a personal account and request withdrawals for deductible amounts, co-payments, and other health care expenses. The pay used for deposits and the amounts withdrawn for health care are tax-free, just as if the company had provided health care benefits directly. The employee has an incentive not to use his or her account because the unused balance is refunded at year-end. The refund is taxable.

REVENUE IMPACT OF LTV'S BENEFIT BANK

The change to the new health care plan and adoption of the benefit bank affect Federal revenues in two ways.

(1) There is an increase in Federal revenue from corporate income taxes due to utilization savings. These company savings amount to about $250 per employee per

year. This increases LTV's taxable income and generates a corporate tax liability of about $125 per employee per year. Design savings to the company can be ignored because they have been passed on to employees through added supplemental pay.

(2) There is a decrease in Federal revenue due to the fact that the benefit bank is used for more than what was cut out of the base health care plan. This added usage amounts to about $225 per employee per year. It decreases employees' taxable income and generates a saving for each employee of about $75 per year in Federal income and social security taxes.

The net effect is to increase Federal revenues by about $50 per employee per year ($125 − $75 = $50).

The Congress and the Administration are concerned that benefit banks will decrease Federal revenue. Though our experience and that of other companies has been just the opposite, there is a potential for revenue decrease in certain situations. For example, if a company were to introduce a benefit bank without redesigning its base health care plan, there would be no utilization savings to increase the company's tax liability. In such a situation, the benefit bank simply would be making available to employees new nontaxable benefits. If LTV were to make a benefit bank available without redesigning its base health care plan, there would be a Federal revenue loss of about $75 per employee per year.

While my experience would indicate that few benefit banks have been established without redesign of the basic health care plan, it is appropriate to be concerned about potential revenue loss.

POTENTIAL REVENUE LOSS

Health care expenditures by the 62 million employees who had some form of employer-provider insurance will amount to an estimated $168 billion in 1984. Of this, $92 billion will be insured by employer plans and $76 billion will be paid out-of-pocket by employees. A rough breakdown of the out-of-pocket payments is as follows:

	Billions
Deductibles and co-payments	$17
Not covered	39
Employee contributions to premiums	20
Total	76

In the event that 60% of employee out-of-pocket expenses were to be paid through benefit banks, $45.6 billion of income could be sheltered from tax. Assuming a 35% rate for Federal income and social security tax, the potential ultimate revenue loss from unrestricted benefit banks is $16 billion. Offsetting this revenue loss is a minimum revenue gain of about $4 billion due to employer cost savings from incentives to increase cost sharing.

"USE IT OR LOSE IT" BENEFIT BANK

Several solutions have been put forth to prevent this potential revenue loss. The IRS has adopted a regulatory solution which is designed to make benefit banks unattractive. The regulations require that deposits that remain unused at the end of the year be forfeited. This concept is called "use it or lose it". If allowed to continue, these regulations will discourage the use of benefit banks as a device to ease the implementation of more cost-effective base health care plans. The trend toward cost sharing will be halted and perhaps reversed.

Companies will still adopt benefit banks, but employees will tend to use them for more predictable health care expenses, such as orthodontia, elective surgery and vision care. Employees will be encouraged to overuse health care at year end because of the "use it or lose it" requirements, and the IRS will lose tax revenue it would have received on year-end refunds.

About $57 billion of out-of-pocket expenses, including employee contributions, will be exposed under the "use it or lose it" approach. If 45% of these expenses were to be paid through benefit banks (usage would be lower than the 60% estimated previously due to the fear of forfeiture), $25.7 billion of income could be sheltered from tax. Assuming a 35% tax rate, the potential ultimate revenue loss is $9 billion. There would be additional revenue loss due to higher utilization of health care to avoid year-end forfeiture.

THE QUALIFIED BENEFIT BANK

Another approach to restricting potential revenue loss is referred to as the "qualified plan" approach. Under this approach, there is no "use it or lose it" requirement, but both the company's base health care plan and benefit bank would have to meet certain cost-effectiveness requirements to be able to offer a benefit bank for health care. As a suggestion, first-dollar benefits might be allowed in the base plan only when there is an effective utilization review program, benefits are for preventive care, or benefits are for a mandatory second opinion on elective surgery. Further, cost-sharing would have to meet certain minimum requirements. In addition, certain exclusions and limitations would be applied to benefit banks, similar to some of those that exist in base health care plans. For example, cosmetic surgery could be excluded and eyeglasses could be limited to $75 a person every two years. A more detailed list of the suggested qualifications is attached.

About 30% of out-of-pocket expenses are incurred by employees whose employers would seek to meet the qualifications. This amounts to $23 billion. If 60% of these expenses were to be paid through benefit banks, $13.7 billion of income could be sheltered from tax. Assuming a 35% tax rate, the potential ultimate revenue loss is $5 billion. This revenue loss would be eliminated by the revenue gain due to employer cost savings from incentives to increase cost sharing and make other cost-effective changes.

MEDICAL COST SHARING BANK

Another approach that avoids "use it or lose it" and has many of the advantages of the qualified benefit bank is the "medical cost sharing bank." This benefit bank is limited to use for medical deductibles and co-payments. As a result, there is the same incentive to introduce cost sharing as with the qualified plan approach, but there is no incentive to introduce other cost-effective changes. The bank would be less attractive to employees because withdrawals could not be made for non-covered items.

To avoid the introduction of ridiculously large deductibles or co-payments for expenses not previously covered, it would be necessary to put limits on cost sharing. For example, the actuarial value of a deductible could be limited to 50% of the expected value of charges to which it applies, and employee co-payments could be limited to 50%.

About $14 billion of employee cost sharing is for medical expenses (another $3 billion is for dental expenses). If 60% of these expenses were to be paid through benefit banks, $8.4 billion of income would be sheltered from tax. Assuming a 35% tax rate, the potential ultimate revenue loss is $3 billion. This revenue loss would be more than offset by the revenue gain due to employer cost savings from incentives to increase cost sharing.

THE IMPORTANCE OF BENEFIT BANKS

Without benefit banks, the trend toward cost-effective health benefits would virtually come to a halt and might even be reversed. If qualified benefit banks or cost sharing banks remain nontaxable, however, there will be a significant revenue gain over the present "use it or lose it" benefit bank and a strong incentive for employers with first-dollar insurance programs to resume the redesign of their programs. Employers will increase the use of nontaxable cost-sharing insurance if they can add benefit banks to ease the transition. They will use the cost saving to reduce taxable employee contributions, increase base pay, or create a nontaxable employer contribution to the benefit bank. And, they will allow employees to add to their benefit bank accounts through nontaxable salary reduction under a "cafeteria" program.

The introduction of more cost-sharing (through benefit banks) will increase the use of nontaxable HMO's and other alternative delivery systems. HMO's are much more appealing as alternatives to cost-sharing insurance than as alternatives to first-dollar insurance. They are a way of retaining first-dollar protection. So, employers will offer more HMO options and more employees will select HMO options. Employers will allow employees to make nontaxable employee contributions for the HMO option under a "cafeteria" program through salary reduction or withdrawals from benefit bank accounts.

SUMMARY

Employers have become increasingly concerned bout the devaluation of their compensation dollar that has come about through the growth of inflexibilities in their compensation programs. In 1978 and 1980, Congress passed landmark legislation that enabled employers to restore flexibility to their programs through "cafeteria" benefit programs. Since January 1, 1983, LTV has offered its employees a state-of-the-art cafeteria program. It is our considered judgement that we are now getting a lot more for our compensation dollar because employees are better able to allocate our dollars than we are. Moreover, they are now actively participating in their benefit programs and helping themselves. Benefits provided under the cafeteria law have not reduced Federal revenues.

One important part of our program, a "benefit bank," is absolutely critical to our efforts to manage health care costs. In response to IRS concerns as to potential revenue loss, we suggest that Congress consider a "qualified plan" or "medical cost sharing" approach and would be pleased to work with you to develop the details.

[Attachment]

SUGGESTED QUALIFICATIONS FOR BENEFIT BANKS

(1) First-dollar insurance benefits must meet the requirements of a, b, or c:

(a) Benefits are administered by an employer, an insurance carrier, or a third-party administrator that has adopted an independent utilization review program that meets standards established by HHS.

(b) Benefits are for preventive care, such as physical exams, Pap smears, and teeth cleaning.

(c) Benefits are for the cost of obtaining a mandatory second opinion as to the need for elective surgery.

(2) Cost-sharing insurance benefits must meet the minimum cost-sharing requirements of a, b, or c:

(a) Benefits are subject to an annual deductible equal to at least 24 times the average straight-time hourly pay rate in effect at the beginning of the plan year.

(b) Benefits are subject to at least 25% employee co-payments, until the co-payments exceed 48 times the average straight-time hourly pay rate in effect at the beginning of the plan year.

(c) Benefits are subject to both deductible and co-payment:

(1) An annual deductible equal to at least 16 times the average straight-time hourly pay rate.

(2) At least 15% employee co-payments until the co-payments exceed 32 times the average straight-time hourly pay rate in effect at the beginning of the plan year.

The same minimum deductible or maximum co-payment would apply to all employees without regard to family size. A higher minimum deductible or maximum co-payment could be adopted for larger family units at the discretion of the employer.

The minimum deductible or maximum co-payment could be pay-related at the discretion of the employer.

The same minimum deductible and maximum co-payment would apply regardless of the scope of benefits to which they apply.

Separate deductibles could be adopted for separate benefits as long as the deductible amounts bore a similar relationship to their respective covered expenses and the total of the deductibles was not less than the minimum requirement.

A schedule of benefits could be used to meet the minimum co-payment requirements if the average payment by employees over the scheduled amount is at least as large as the minimum requirement.

(3) Benefit banks must meet the requirements of a, b, or c:

(a) Health care withdrawals exclude expenses not normally paid by insurance plans and HMO's: home and vehicle improvements, cosmetic surgery, amounts in excess of reasonable and customary charges, special foods, nursing and special homes, and transportation other than ambulance service.

(b) When added to insurance benefits, health care withdrawals are limited for (1) eyeglasses to $75 per person once every two years and (2) orthodontia to $1,000 for each person.

(c) Unused deposits in benefit banks are non-forfeitable and refunded at year-end in the form of cash or transfer to a capital accumulation plan.

The entire health care benefit program would have to qualify under these rules for the benefit bank to be nontaxable.

STATEMENT OF JAY R. STOREY, VICE PRESIDENT OF PERSONNEL, THE MAYTAG CO.

SUMMARY

Statistical Tables show:

(a) How much is spent for benefits and how much is tax favored.

(b) What the wage levels are of those employees who participate in those benefit plans.

Benefit levels are set by negotiations.

Negotiated benefits become the model for all other levels in the organization.

Company is not motivated to have too large a portion of its compensation in benefits.

Hypothesis that if benefits ar treated as taxable income, unions and companies will move towards wage increases and less benefits which will ultimately put more burden and stress on government to provide the benefit.

STATEMENT

The attached set of statistical tables show that 10% of people receiving benefits under the Medical and Retirement programs at Maytag earn between $10,000 and $20,000; 87% earn between $20,000 and $50,000, and only 3% of those in the plans earn over $50,000 per year.

I want to tell you how benefit levels are established at Maytag. It seems that some feel management sits around thinking up ways to give new benefits to themselves and other employees. In actual fact, they (managment) spend much more time worrying about the cost of their current benefit plans (medical, dental, vision, retirement, etc.) and what they can do to control these costs. Any new benefit that is granted is additional business expense and adds to the cost of our products.

In my 30 odd years at Maytag, our benefit programs have developed as a direct result of contract bargaining with the UAW. This procedure unfolds like this:

(a) The union submits its demands which includes a long list of improvements to current benefit plans and for new plans, along with their proposed wage increases.

(b) In typical give and take fashion, negotiations reduce the demands to a level acceptable to both parties. This settlement level is based on the total amount of money which the Company is willing to spend for both wages and benefits in that particular round of bargaining. Each benefit improvement is carefully and meticulously costed and included in the total cost of the package of improvements or concessions as the case may be.

(c) The Company usually says to the union—we don't care how you divide the money up between wages and benefits, but there is no more money.

(d) The union decides which benefits to select by sampling and/or sensing the needs and desires of the membership.

The benefit package thus negotiated becomes the model with minor variations for the rest of the organization, including top management.

At Maytag, the folowing plans are exactly the same for management as union employees: (a) Medical, (b) Dental, (c) Vision, (d) Drug, (e) Accidental Death & Dismemberment Ins., (f) Holidays, (g) Dependent Life Ins., and (h) Educational Assistance Program.

The retirement plan for management is based upon a percent of the highest five consecutive years of earnings out of the last ten, where union employees currently receive $17.50 per month per year of credited service. This works out that the average hourly employee gets a higher percent of final wages than management employees receive. This is common throughout industry.

The Company is motivated to not let too large a portion of compensation (wages and benefits) to be in the benefit area because in the competitive labor market of hiring new employees and, to a certain extent, retaining current employees, it is the wages and salaries that attract and hold good empolyees, particularly the younger ones. You just don't get full credit for dollars spent for benefits.

The question has been posed—"What would the outcome be if benefits provided by the employer were treated and taxed as regular income"? It is my belief that if this was done, unions would more and more opt for negotiating wage increases and rely on the employee to determine and purchase what benefits they individually wanted. Since the Company feels that they do not get full value for money spent for benefits, they also would be willing to let this happen to a great extent. I submit this would result in employees not uniformly buying the needed level of retirement and medical benefits. More and more people would then turn to the government and welfare for relief.

TABLE 1.—EMPLOYEE BENEFIT DOLLAR COST, BY CATEGORY, 1983

[In thousands of dollars]

Benefit	Employer payment	Per employee
Total benefits	38,069	12.2
Legally required employer payments	7,766	2.5
Social Security	5,303	1.7
Unemployment compensation	1,971	.6
Workers' compensation	479	.2
Other payments	13	
Discretionary taxable benefits	9,780	3.1
Time not worked	5,877	1.9
Rest periods	3,723	1.2
Other taxable benefits	180	
Discretionary tax-favored benefits	20,523	6.6
Defined benefit pension plans	10,004	3.2
Capital accumulation plans	0	
Disability plans	256	.1
Group health and life insurance:		
Active workers	6,924	2.2
Retirees	3,283	1.1
Other tax-favored benefits	56	

TABLE 2.—EMPLOYEE BENEFIT PERCENTAGE COST, BY CATEGORY, 1983

Benefit	Employer payments as percent of wages and salaries	Employer payments as percent of all benefits
Total benefits	44.5	100.0
Legally required employer payments	9.1	20.4
Social Security	6.2	13.9
Unemployment compensation	2.3	5.2
Workers' compensation	.6	1.3
Other payments		
Discretionary taxable benefits	11.4	25.7
Time not worked	6.9	15.4
Rest periods	4.3	9.8
Other taxable benefits	.2	.5
Discretionary tax-favored benefits	24.0	53.9
Defined benefit pension plans	11.7	26.3
Capital accumulation plans		
Disability plans	.3	.7
Group health and life insurance:		
Active workers	8.1	18.2
Retirees	3.8	8.6
Other tax-favored benefits	.1	.1

TABLE 3.—RETIREMENT PROGRAM AVAILABILITY, 1983

	Defined benefit				Employer capital accumulation				401(k)			
	Participate		Vested		Participate		Vested		Participate		Vested	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
0 to $9,999					NA	NA	NA	NA	NA	NA	NA	NA
$10,000 to $19,999	310	10	144	6	NA	NA	NA	NA	NA	NA	NA	NA
$20,000 to $49,999	2,709	87	2,019	90	NA	NA	NA	NA	NA	NA	NA	NA
$50,000 to $99,999	85	3	79	4	NA	NA	NA	NA	NA	NA	NA	NA
$100,000 or more	6		6		NA	NA	NA	NA	NA	NA	NA	NA
Total	3,110	100	2,248	100		100		100		100		100

TABLE 4.—HEALTH BENEFIT AVAILABILITY, 1983

	Group insurance		125 Plan		HMO	
	Amount	Percent	Amount	Percent	Amount	Percent
0 to $9,999			NA	NA	NA	NA
$10,000 to $19,999	310	10	NA	NA	NA	NA
$20,000 to $49,999	2,709	87	NA	NA	NA	NA
$50,000 to $99,999	85	3	NA	NA	NA	NA
$100,000 or more	6		NA	NA	NA	NA
Total	3,110	100		100		100

TABLE 5.—RETIREE BENEFITS

Benefit	Number of Persons	Total distributions or cost (thousands)	Year
Defined benefit plan: retirees in pay status	1,502		1983
Pension benefits paid:			
Retirement		$8,802	1983
Death		132	1983
Defined benefit plan: retirees survivors in pay status	198		1983
Defined benefit plan vested: separated	225	NA	19—
Capital accumulation plan: retirement age distributions	NA		19—
Captal accumulation plan: termination distributions	NA		19—
Retiree health	1,827	3,283	19—
Retiree life	1,515	(1)	19—
Retiree other			19—

[1] Cost for this item is not available separately—cost is included in total pension cost of $10,004,000.

NATIONAL ASSOCIATION OF CASUALTY & SURETY AGENTS,
Washington, DC, September 20, 1984.

Hon. FORTNEY H. STARK,
Chairman, Select Revenue Measures Subcommittee, Ways and Means Committee, House of Representatives, Washington, DC.

DEAR CHAIRMAN STARK: The National Association of Casualty and Surety Agents (NACSA), an association representing the leading commercial property/casualty insurance agencies and brokerage firms throughout the United States, would like to submit for the hearing record on taxation of employee fringe benefits the following brief comments.

NACSA opposes the Administration's proposal to tax employee health care benefits, whether used to raise funds to reduce the federal deficit or to provide health care to the nation's unemployed. NACSA opposes in principle this tax as both discriminatory and unfair. We also believe strongly that this proposed tax would not raise the revenues suggested by its proponents.

A health insurance tax cap proposal would discriminate against older workers, those in high risk occupations, and those living in areas with a high cost of living since these groups pay higher premiums than the average for the same health insurance. NACSA believes it would be unfair for these workers to pay more in taxes than others for the same health protection.

NACSA believes further that using a tax on employee health care benefits to fund the federal deficit or health insurance for the unemployed would be unwise for other reasons as well:

(1) Revenues from the tax would be unpredictable since employers may shift taxable employee health benefits to other non-taxable fringe benefits. Also, if the tax achieves it objective, many employee will move to health plans with premiums at or below the proposed tax threshold, eliminating much of the projected revenue gain;

(2) Linking a short-term assistance program to a permanent change in the tax code would make it difficult to eliminate the temporary program when its usefulness ends;

(3) This tax would constitute a form of double taxation. Since the government does not reimburse hospitals for all costs associated with treating Medicare/Medicaid patients, the private sector is forced to absorb the difference. In 1982 alone this 'cost shift' amounted to $5.8 billion. This, in effect, is a hidden tax. It would be unfair for the government to shift these costs to private payors of health care and then tax the resulting higher premiums!

(4) Greater unemployment may result for the marginally employed (the aged, sick, and disabled) as a result of such a tax. A tax on employee health benefits would present a greater disincentive than under current law to employers to hire or retain these workers whose predictably higher health care costs drive up insurance costs for all employees in a group.

(5) A tax on employee health benefits may reduce employer incentives to offer and provide health insurance. Employer plans have broadened the availability of medical coverage to Americans and improved the health and welfare of the vast majority of our citizens. It has also lessened the burden on the government to provide national health benefits above and beyond those provided by Medicare/Medicaid programs.

(6) Finally, such a tax may remove incentives for employers to continue any health benefits voluntarily afforded to laid-off workers. To the extent that health insurance premiums for the unemployed would be counted as taxable income, employer payroll tax costs (FICA and unemployment) would increase. As these costs rise, employers might determine that they can no longer afford such voluntary benefits.

Mr. Chairman, NACSA recognizes the breadth of your recent joint hearings on fringe benefits has gone beyond a tax cap on employee health benefits. Since the issue of employee fringe benefits will be the subject of further debate in the next Congress, we would like to reserve the right to submit additional comments next year on health care benefits and other employee fringe benefits under consideration by your subcommittee and others.

Sincerely,

JOAN ALBERT DREUX,
Executive Director, Government Affairs.

STATEMENT OF THE NATIONAL EMPLOYEE BENEFITS INSTITUTE

INTRODUCTION

The National Employee Benefits Institute ("NEBI") is an organization composed of Fortune 1000-sized companies which share a common interest in legislation and regulations which impact benefit planning. NEBI represents more than $100 billion in pension assets, and its members employ hundreds of thousands of workers who are covered by many types of benefit programs.

The NEBI statement was prepared through the combined efforts of benefits managers at the following nine member companies: 3M Company, American Can Company, Atlantic Richfield Company, Conoco, Inc., First Interstate Bankcorp., Hunt-Wesson Foods, Inc., Security Pacific National Bank and Southern California Edison. Although this statement necessarily reflects these companies' experiences as large employers, the composite employee group depicted in this joint project are an extremely diverse work force who live and work in all regions of the United States. The employees described in this statement include the young and old, male and female, married and single, those who perform manual and clerical jobs and those who have technical, professional, managerial or executive positions. The one characteristic they share is their employment by major companies who are actively interested in the current health and welfare of their employees and dependents, and who want to provide economic security in the event of their separation from service, retirement, death or disability.

NEBI wishes to express its appreciation to the Subcommittees on Social Security and on Select Revenue Measures of the House Ways and Means Committee for the opportunity to present this statement and supporting data concerning policy issues related to the distribution and economics of employee benefits.

Millions of American workers and their families count on private benefit plans as a primary or supplemental source of current assistance and future security. To a great extent, it is anacronistic to characterize such programs as retirement and health care plans as "fringes." They are, rather, an integral part of the total compensation paid to employees. The Internal Revenue Code and regulations, ERISA, ERTA, TEFRA and this year's DEFRA, plus innumerable labor laws and regulations have created a complicated, interrelated, regulatory framework upon which thousands of intricate benefit programs have been built. Public programs have assumed the continued existence and vitality of private ones and vice versa. Congess, business and labor have all contributed to the final product. It is not surprising that fringe benefit legislation and regulations, as well as the plans which they govern, reflect a balance among competing revenue, commercial and social interests.

Our statement will focus broadly on three major areas: the economic and fiscal implications of the current employee benefit tax policy; a discussion of the labor force currently covered by employer-paid, tax favored benefits; and the historical and social medium in which employee benefit plans as we currently know them germinated.

Economic and fiscal implications

Large federal deficits have caused widespread concern in the executive and legislative branches as well as in the private sector. Although there is little dispute that something must be done to reduce the deficit levels, few programs or persons are willing to assume the role of "bullet biter" voluntarily. Congress is absurdly pressured to cut spending and increase revenues without raising taxes or disturbing anyone's favorite program. This cannot be done. A reevaluation of many tax exemptions, deductions and credits is one logical approach, and may provide an opportunity to eliminate some inadvertent or obsolete exclusions. But before any changes are warranted, it is appropriate to consider carefully the reasons for creating such "tax expenditure" and the impact that removal would have on the economic and social well-being of the American people.

The current focus on employee benefits as a potential source of substantial additional revenue presupposes two premises: that a significant amount of revenue is permanently "lost" through benefit programs, and that the losses are not justifiable in light of the more compelling revenue considerations. NEBI disagrees with both of these propositions.

1. Only a small portion of Employee benefit-related revenue is permanently lost to The Treasury. Employee benefits may be divided into three basic categories: tax free, tax deferred and fully taxable.

(a) Tax free benefits.—Health-related benefits are the primary component in the "lost revenue" category of tax free benefits. Employers contribute an average of 5% of payroll to provide health-related benefits. To the extent payments are made to health services providers who are subject to income tax (such as physicians), the payments will be taxed to a taxpayer (the physician) soon after employers make the payments.

(b) Tax deferred benefits.—The second category, tax deferred benefits, includes pension, profit sharing and other employee savings plans. Although contributions to these plans reduce current revenue, the deductible contributions will eventually return, interest augmented, to the income stream. Even after adjusting for inflation and tax breaks for the recipient, one study shows that as much as 60% of the contribution amount will return to the tax base as taxable income.[1] Federal revenues are reduced to a small extent by tax credit employee stock ownership plans (commonly called "PAYSOPs"). However, the reduction is arguably offset by the increased productivity of workers who become company shareholders.

(c) Fully taxable benefits.—The majority of "benefit" dollars do not receive tax-favored treatment. According to U.S. Chamber of Commerce figures, over two-thirds

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[1] S. Korczyk, Retirement Security and Tax Policy (Washington, D.C., Employee Benefit Research Institute, forthcoming).

of employee benefits (23.5% of payroll) are fully taxable, discretionary employer-paid benefits such as paid vacation, holidays, lunch periods and sick leave, most of which are subject to both income and social security taxes.[2] Another 9.5% are in the form of legally required employer payments (social security, unemployment compensation insurance and worker's compensation insurance). Accordingly, there are no revenue enhancement possibilities for the majority of benefit dollars currently spent on behalf of U.S. workers.

2. Lost Revenue is Justified by Balancing Considerations. The tax exempt treatment accorded by Congress to the relatively small amount of fringe benefit payments that are tax exempt to the worker reflect a policy commitment to ensure the provision of medical coverage to as broad a cross section of the American population as possible, and to encourage the private sector to assume much of the responsibility for this coverage. Thus far, this nation has indicated a strong preference for a private health care system over a national health insurance system (such as that in place in Great Britain.) Actual tax revenues "lost" in implementing this country's private health care system should be compared to the administrative cost of a government-sponsored program. To imply that taxation of health care benefits would enhance revenue rolls dollar for dollar overlooks the hidden costs of collecting this revenue.

3. Employer-provided health benefits are delivered at a relatively low cost. Since the 1960's, our member companies have experienced a dramatic rise in the cost of providing health care coverage for their employees. As one example, Conoco reports that in 1972 its medical plan was funded at 1% of the cost of its payroll. Today it is 6% of payroll. Conoco is only one of the victims of this phenomenon. However, the private health care system is not the cause of rising health care costs and should not be looked to as the source of the solution.

In making such a statement we do not intend to imply that the private delivery system is without fault, nor do we minimize the crisis caused by the rise of health care costs. NEBI companies, along with large and small employers everywhere, have begun to implement programs to contain rising health care costs. Current efforts include greater employee cost sharing, reduced benefits, sophisticated data monitoring systems and employee health incentives. Member companies report plans operating at a high level of efficiency, with 95% of medical plan dollars being paid out as benefits.

Our members believe that many factors have contributed to the health care cost explosion. The high cost of new technology is a primary catalyst of cost increases. Other factors include overabundant hospital beds, overutilization and failure to reduce cost of procedures as they become less expensive to perform. NEBI believes that Medicare, as the single largest health care plan, can and should assume a leadership role in holding down the cost of medical care delivery. However, the companies represented by this organization do not believe that a more comprehensive government-sponsored health care program would alleviate the health care cost crisis. In fact, most cost-savings techniques employed by companies today started through the efforts of a few innovative companies. Without experimentation by many companies and competition among providers (generated by industry's concern for high costs), new and more efficient delivery systems would not emerge.

4. Employee benefit plans are major sources of savings for the majority of current pension participants. It has long been part of our national economic policy to encourage savings and investment by American workers. Yet, Japan and the Scandinavian countries have personal savings levels which approximately triple the American rate of under 5% of net pay. NEBI member companies indicate that their profit sharing, savings and thrift plans are the sole or major voluntary savings programs for most employees. Just as important, company-paid pension and other retirement plans will be the major source of income for future retirees.

One of the chief characteristics of the new industrial age was reduced personal retirement savings, requiring government to assume an unfamiliar role in providing assistance for the post-employment years. Tax incentive provided to companies and their employees in order to encourage retirement self-sufficiency are no less valid government tax expenditures today than when first established.

5. Current and future employees will retire with larger savings. There is a twofold economic consequence of the post-ERISA trend toward greater retirement savings in company-sponsored plans.

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[2] Employee Benefit Research Institute, Why Tax Employee Benefits?, Table 1. (Washington, D.C., 1984)

(a) Reduced pressures on government.—Future retirees will be less dependent on Social Security or Medicare due to longer participation in defined benefit and defined contribution plans. The stronger the private retirement system, the more prepared we will be to cope with the huge Social Security deficits which are predicted for the coming years. At some point in the near future, economics will force us to take a hard look at our public old-age health and welfare delivery system.

By whatever means, government must pay the cost for retirement benefits. Congress must choose whether the government will take a more active role through the administration of the gargantuan Social Security System or continue to be an inactive participant which "pays" through reduced revenues. Congress must determine whether it is in the nation's best interest for government to shoulder more of this burden.

(b) Assets paid out of retirement plans will be taxed.—The second result of having a nation of better-off retirees is that a much higher percentage of deferred tax dollars will eventually find their way into the Treasury as post-retirement income tax payments. Drastic drops in income tax brackets between the pre- and post-retirement employee's income will not remain the rule. Our members report that their retirees are leaving the work force with a retirement income ranging from 40–100% of their preretirement earnings. The higher percentages are at the lower end of the wage scale.

Even considering the various tax advantages (such as rollovers and ten year forward averaging) given to the benefit recipient, the Treasury is not permanently losing, dollar-for-dollar, the amount of money calculated to be benefit-related tax expenditures. For example, in 1983, Conoco's annual retirement plan contribution (and tax deduction) was $27 million. The same year over $46 million (all taxable income) was paid to about 3700 retirees. As the number of vested retirees continues to grow, and they earn a larger pension benefit due to longer service under the plan, the government can anticipate more recaptured revenue. In fact, the fairly conservative funding standards adopted by most corporations, improved retirement benefits to employees, longer life expectancies for current and future retirees and the changing demographic distribution which will accompany the aging of the baby boomers will create an environment in which the difference between tax dollars deferred and recovered should narrow dramatically.

6. More Retirement Dollars Will Be Needed. The demographic changes expected as America enters the twenty-first century should not be overlooked. The retirement planning implications are enormous. What is needed to support a small, post-retirement population with a relatively short remaining life expectancy is quite different from the resources required to maintain at an adequate income level a far larger, longer-living group. Although never intended to supply full retirement income, Social Security and Medicare will be less prepared to cope with the twenty-first century's population distribution. Inflation is another serious problem. Carefully planned retirement savings must account for dollar dilution in the post-employment years. Cost of living increases—and the funding necessary to supply them—will become even more important.

We, as a nation, have given much thought to these and similar issues beginning with the Revenue Act of 1921 (exempting interest income on trusts for stock bonus or profit-sharing plans from current taxation) and continuing through to the most recent tax law. We are only now beginning to appreciate the post-ERISA economic impact of well-funded, broad-based private pension coverage.

A broad based labor force shares in employee benefits

One of the most frequently voiced concerns with employee benefits is the assertion that the current tax structure has created a system benefitting the corporation and highly compensated individuals by providing deductions and tax shelters.

ERISA was the first comprehensive attempt to guarantee that retirement benefits would be widely available. More legislation followed. Nondiscrimination rules have been enacted to insure that both use and availability of statutory fringe benefits are nondiscriminatory. The top-heavy rules of section 416, contribution limitations under section 415, and relevant sections of the Age Discrimination in Employment Act, among others, have further assured widespread availability of employee benefits. In fact, there is great concern that Congress has gone too far in assuring nondiscrimination. The complexity of, and disincentives inherent in, recent legislation threatens the continuation of retirement plans, especially defined benefit plans and plans maintained by small employers.

The body of laws governing the employee's retirement benefit incorporates such features as the following: fiduciary responsibilities on all plan sponsors, trustees, administrators, consultants, attorneys and others; reporting and disclosure requirements; minimum funding standards; nondiscrimination tests; and tax incentives. Among the plan watchdogs are: the participants themselves; the business community; the plan fiduciaries; the Internal Revenue Service; the Department of Labor and the Pension Benefit Guaranty Corporation. Current and future benefit recipients should be confident that their employer-funded retirement savings will be available as expected.

New legislation has focused upon incidental discriminatory impact issues, such as breaks in service related to maternity or paternity leave and gender-based vesting gaps. NEBI believes that legislation has been an appropriate remedy where large numbers of workers have been adversely affected, either willfully or incidentally, by certain legal requirements or commonly-included plan provisions. It is our contention, however, that after ten years of operating under ERISA, the benefit plan problems which deserved legislative solution have been virtually eradicated, and any remaining vestiges of discrimination by plan design or administration are more appropriately dealt with by market forces.

A competitive advantage in the marketplace is a primary impetus for offering fringe benefits and retirement plans. Regardless of any tax advantages to the company or participant, it is illogical to assume that an employer would provide any benefit in lieu of the more easily understood and administered direct compensation if there were not pressures from within the work force to do so. And although the private system may not be perfect in design and delivery, the population participating in fringe and retirement plans is larger than ever, and is virtually identical to the composition of the employment force as a whole.

1. Coverage and vesting gaps between men and women are narrowing as more women enter and remain in the work force. Statistics show that approximately half of the American work force is comprised of women, with more than one-half of adult women now workinig outside of the home. The figure rises to 70% for adult female "baby boomers." With a growing awareness of the political and economic force generated by this expanding group, both legislative initiatives and market factors have provided these women with greater and more equitable benefits than ever before.

NEBI respondents report a closing gender gap in employment and vesting. One example is First Interstate Bankcorp. This company has a rather atypical gender mix of approximately 60% female to 40% male. Although an observer might assume that men would dominate the long tenure positions (executive and managerial), which would result in a widely disparate male-female mix at the retiree level, this is not the case. Of the company's 3,603 actual retirees, 58% are female and 42% male. Women at this company are becoming vested and staying at First Interstate Bankcorp. until retirement.

Certain fringe provisions are a reflection of the large number of women who remain in the work force through their childbearing years. Hunt-Wesson cites as an example its liberal maternity leave policy (offered as part of its disability plan), which provides 100% of pay for six weeks with an additional six weeks off at full pay if medically indicated.

Another example is the dependent care assistance program. In many companies this program has made economically feasible, for many women with small children, the decision to seek and retain employment outside the home. It is not only the working mother who benefits from this assistance. The accessibility of quality child care at more affordable prices is advantageous for the entire family.

There are other benefits, such as educational assistance, which are more widely utilized by women and lower income wage earners than by the older and higher-paid employees. Atlantic Richfield's (ARCO) educational assistance program is evidence of this tendency. ARCO reports that its program's primary participants are young female clerical workers who are at the lower end of ARCO's wage scale. These women are returning to school with ARCO's assistance in order to obtain the skills to qualify them for management track positions. Not only are these young clerical workers benefitted personally by the availability of educational assistance, the employer reaps the benefits of a more diverse management team in an industry that has historically tended to be dominated by men at all levels.

2. Lower income individuals would suffer severe economic consequences if required to purchase or pay for benefits currently provided by employers. Although anticipated retirement income needs and the size of retirement benefits will vary along income lines, many fringe benefit programs, including large catastrophic medical and other welfare benefits (such as dental, disability and life insurance) are totally independent of income level.

According to a 1982 Bureau of Labor Statistics survey, corporations paid 65% of all health insurance premiums, and 93% of all workers are covered by long and short term disability insurance. First Interstate Bankcorp's health insurance plan requires a premium of up to $246 per month for family coverage, of which the employee must pay approximately one-third. If the employer did not pay the majority of this premium, the impact on the $20,000 combined income family would be much greater than on the $80,000 combined income family. The financial burden of medical insurance, without regard to any life insurance or disability coverage, could leave many families unprotected or underprotected, and vulnerable to economic catastrophe.

Informal polling by some of our steering committee members indicate that there is an inclination among younger employees to respond that they would terminate benefits in favor of increased compensation if the employer ceased to provide these fringes. Although NEBI does not propose that these unscientific samplings are of any value beyond the anecdotal, certainly they point out certain significant issues which need to be addressed. We must consider the future scenario in the event that employer incentives were eliminated or significantly changed.

For example, let us assume the most drastic case, that all tax incentives to employers were eliminated and Employer X decided to terminate all benefits and retirement programs. Employees would fall into three categories: those who could and would replace critical benefits out of their own resources (through, for example, the purchase of high-cost individual coverage); those who financially could, but would not, duplicate the employer-paid benefit coverage; and those who simply could not afford to replace the benefits in any meaningful way. This last group would consist of lower paid workers, persons who because of their age, hazardous occupation or some other factor would be priced out of the health, disability and life insurance markets. Their other more pressing obligations or higher priorities would force them to "play the odds." Inevitably, after enough catastrophes, there would be an increased demand placed upon government assistance programs. Congress would feel compelled to do something to breach the benefit gap. How much of the burden would fall on the employees directly and how much would be left in government's hands is, of course, impossible to state with any certainty.

NEBI's member companies anticipate a wide range of responses to elimination of tax incentives. The possibilities range from the institution of some degree of employee cost sharing to the complete elimination of current benefit programs. Although employers recognize a certain moral obligation towards their employees and dependents, this is not enough to offset completely their financial obligation to shareholders. Neither is it sufficient to withstand the pressure from employees who are unwilling to share significantly in benefit cost.

Historical coalition for social progress

Throughout this statement, we have made allusions to the important role played by the private sector in the implementation of the nation's social programs. In 1890, only 3.9% of the total population of the United States was 65 years of age or older. That year, 4.3% of the labor force was composed of persons age 65 and older. By 1983, this same age group represented 11.6% of the total population. The projection for the year 2013 is that persons over age 65 will make up 14.7% of the total population. Between the years 1890 and 1976, however, the percentage of the total labor force over age 65 actually declined. Although a law prohibiting mandatory retirement prior to age 70 may have some effect on the number of persons who remain in the work force beyond age 65, it is clear that the present and future prognosis is that the population spread between the younger working segment and older nonworking segment will continue to narrow. Because this latter group continues to increase in number and percentage of the population, Congress must establish its policy towards the nonworking elderly now.

1. Private employee benefit plans are necessary components in Congressional social programs such as retirement security, health care, educational assistance, employment security and worker's compensation. The Social Security Act of 1935 created the first national program of social insurance, the Federal Old-Age, Survivors, and Disability Insurance (OASDI) program. Social Security was established to be an emergency adjunct to retirement income, whether derived from employer's-sponsored retirement plans or personal savings. Although Social Security was not one of the most popular enactments of the New Deal program of President Roosevelt at the start, it quickly gained popularity, and through the next decades additional programs were added to the original retirement program: supplemental security income, Medicare and disability benefits.

The unfunded "pay as you go" Social Security system became increasingly problematic as the number of recipients grew, as the benefits increased and as cost of living increases were mandated by inflation. The enormous costs incurred by this program are carried by current wage earners who are taxed on current earnings. As the percentage gap between workers and retirees narrows and as retirees live longer, this tax rate must grow. A nationwide attitudinal survey toward Social Security prepared for the National Commission on Social Security in 1981 indicates that the public is well aware of the implications of these facts and numbers: 61% of the non-retired respondents expressed doubt that the funds would be available to pay their retirement benefits. Of those between the ages of 25 and 44, almost 75% gave this response.[3] The purpose of this statement is not to discuss the merits of Social Security, nor to suggest means of reform. Rather, it is intended to show that the public retirement system has been strained due to economic and demographic factors. A "pay as you go" system can be disastrous during periods of high inflation. Increased payments must be made from currently collected dollars. Wage earner tax dollars must be used directly for administrative costs, so that the tax expenditure cost to the government is exacerbated. An adequately funded private system must supplement this "pay as you go" social security system.

Any reform which would discourage private sector retirement plans while increasing demands on public programs ignore certain critical economic facts about the present retirement income system. Social Security was intended to supplement private retirement income sources. Private plans alleviate some of the social and fiscal pressures on government. From the fiscal perspective, private plans reduce government expenditures needed for retirement payments (and provide a pool of investment capital for the national economy). Private plans must be adequately funded, providing additional capital and interest dollars. The interest dollars will help defray the plan's administrative expenses and provide cost of living adjustments as they are needed.

Omitting any tax adjustment at payout, the Treasury's eventual recovery may be expressed as follows: dollars contributed to plan + interest − administrative cost = dollars returned to income stream.

From the government's perspective, this dollar cycle compares favorably to the Social Security system. Social Security collects contribution dollars (which are reduced by payments of administrative costs) and almost immediately pays them to the recipient without the intermediate stop in the economy as invested capital. Although this model is simplistic, it demonstrates that the private pension system is beneficial to the economy.

From the social standpoint, private plans play a key role. At the time it was enacted, Social Security was a drastic response to a social and economic crisis. Prior to the Industrial Revolution, a young, agrarian nation could take care of its elderly. Extended families jointly operated farms where the few who survived to old age remained productive in some manner so long as he or she was physically able. The industrialization of America brought about social changes in our work and living habits which could not accommodate the Great Depression.

2. Social Security was not intended to provide universal retirement income. Social Security and private retirement plans are intended to supply retirement income to wage earners. The essential difference between them is that Social Security was intended as "insurance." Henry L. Bowden, a member of the President's Commission on Pension Policy, commented in 1981, that "the social security system insures against an inadequate income at the time of retirement. If you have an adequate income at time of retirement, you have not suffered the loss against which were insured."

Federal policy has been legislatively expressed. There's a commitment to provide the retired with adequate income. Opinions may differ over how much assistance is appropriate and who should pay the bill. Some of the "how much?" questions have been answered by the Congress. The basic Social Security benefit operates within prescribed limits. For the private sector, Congress has established retirement plan contribution and benefit limits. The next question is "who provides?"

Congress had hoped that people would voluntarily save without tax incentives (and, through IRAs, with tax incentives). Because personal savings have not been sufficient to ensure post-retirement security (and because low income persons, who need savings most, have not used IRAs as much as higher income taxpayers), government requires that employers and covered employees make mandatory contributions to Social Security. The private sector employer is induced to do its share with tax incentives. The government necessarily "pays" one way or another for the implementation of its stated policies. Companies, employees and their dependents await your eventual decisions on the future of employee benefits.

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[3] National Commission on Social Security, A Nationwide Survey of Attitudes Toward Social Security (1981).

3. Tax incentives to employers have encouraged flexibility and innovation in approach and design to accommodate different geographic areas, age groups and employee needs. Let us assume that the government can deliver health, retirement and disability benefits at no greater cost than the private sector. Even at identical price there are sound reasons for delegating some of this responsibility to the employer. The employer is in a position to respond to the individual needs and demands of its employees. Note that fringe benefits have always been a major subject of collective bargaining agreements.

Our member companies affirm that employees are not passive recipients of benefits. Rather, competitive forces spur the creation of an attractive benefit package which will induce the best possible candidates to choose and remain with a company. While young workers may be less concerned with extensive defined benefit programs, they may be very interested in generous maternity benefits, dental plans and child care assistance. An older population mix may demand retirement security and a savings plan with self-directed investment options. Only a decentralized, market sensitive benefit delivery system can permit such fine tuning. NEBI does not believe that total uniformity is in the country's best interest.

4. Tax incentives to employers have encouraged private sector cooperation in other policy areas. Collecting revenue is only one item on the congressional agenda. The nation has set certain other goals involving quality of life. Education is to be readily available to as broad a segment of the population as possible. Therefore, the government has established low interest loan programs and has historically given employers the incentive to establish their own educational assistance programs.

Quality of life in congested urban areas is another national interest. The government has provided direct aid to local govenment for mass transportation systems and provides employers with the incentive to set up qualified transportation programs. These plans are beginning to show results. For example, 52% of Atlantic Richfield's Los Angeles employees are voluntarily participating in a qualified transportation program. Participants are reimbursed for parking costs if they form a car pool of three or more riders. The plan also covers van pools and individual use of public transportation. Such programs are new and relatively untried by most employers. NEBI asks this Subcommittee to consider this question: Is the cost through tax loss to the federal government any greater than that occasioned by direct payment of highway assistance or implementation of an air clean-up program? Even an employer-provided lunch program has value beyond employer convenience. It allows some employers to locate in less urbanized areas, perhaps creating needed jobs.

5. Compensation increases in the form of retirement benefits tend to be less inflationary than direct compensation increases. These contributions are properly characterized as savings, and savings do not add fuel to the inflationary flame. The emphasis is on the retirement benefits because some benefits are immediately paid into the economy and are not "saved." Health benefits coverage is the easiest and most obvious example.

Health benefits are intricately tied to the alarming inflationary spiral in health care costs. However, this is one instance where the application of the old maxim, "Don't throw out the baby with the bath water" is appropriately repeated. Employers have recently been forced into devoting more and more of their available benefits and compensation dollars to provide the same, or in many cases an inferior, health benefit package. Our member companies, and we believe them to be representative of all employers on this issue, are vigorously working to find solutions to the problem we have described. Employers, who must show profits to their investors, are working to find innovative ways to control health benefits costs. We believe that thousands of employers, working in competition in the marketplace, will discover more ways to save costs than one government-mandated program could ever do. Employers and participants are starting to learn some hard lessons about health care expectations. A punitive tax structure is not the solution. The private sector requests the cooperation of Medicare and Medicaid in finding the proper course.

CONCLUSION

Many member companies have asked themselves a very difficult question: In the event of a major tax incentive overhaul, would they be able to provide the same protection to their employees, or even adequate protection for the present and future health and welfare needs of their employees? Respondents report that it is too early for their companies to actually make decisions, but that they believe that their companies would have to completely eliminate all benefit programs or severely curtail the employer contributions to them.

Congress, business and labor have cooperated for over 50 years in setting up a joint public-private employee benefits system. Before upsetting the balance, the government must rethink a complex structure. Congress has listened to business and labor and has been responsive to their needs in this area for many, many years. Look now to the future. We ask the Subcommittee and the full Congress to decide whether the real social and long term revenue costs of tax revenue increases in the employee benefits area will be too high.

STATEMENT OF MARTIN D. WOOD, DIRECTOR, RETIREMENT, SAFETY, AND INSURANCE DEPARTMENT, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

Mr. Chairman and members of the House Ways and Means Committee, my name is Martin D. Wood. I am the Director of the Retirement, Safety and Insurance Department of the National Rural Electric Cooperative Association (NRECA) and the Administrator of the various welfare and pension programs sponsored by NRECA for its members. NRECA is the national service organization of the approximately 1,000 rural electric systems operating in 46 states. These systems bring central station electric service to approximately 25-million farm and rural individuals in 2,600 of our nation's 3,100 counties. Our various programs provide pension and welfare benefits to over 110,000 employees and their dependents in those localities.

We are pleased to have this opportunity to present information to the Committee on our programs and the social purposes they serve. We know that as Congress faces the difficult task of reducing the budget deficit, it will rethink many of the policies that until now have shaped our tax laws. There will be great pressures to abandon previous, long term commitments and seize upon shortsighted plans to raise revenues without thought to the long term consequences to the nation. We are aware that the treatment of employee benefits is one of the policies that has been suggested for re-examination, especially because of the large amounts of revenue involved.

Employer provided benefits serve essential social purposes. They provide medical care when the worker or his family is sick, income when he is disabled, a pension when he retires and an estate to his family when he dies. They collectively involve very large amounts of money because they assume great social obligations. Any attempt to change the present treatment of benefits for short term revenue gains will have a drastic effect on the provision of these benefits. These are issues of long term consequence; changes should not be made for merely short term gains.

Today it is difficult to recall the state of the nation's rural citizens in the 1930's and 1940's. Social Security was a new, radical innovation and employer provided retirement plans were almost unknown for rank and file employees. Health insurance (and indeed health care) was not a major concern of government or employees. Basically, rural Americans were left to fend for themselves so far as life, health, disability and retirement needs were concerned. As rural electric cooperatives were formed throughout the United States in the 1930's and 40's they needed to secure insurance, both to protect themselves and their employees from economic loss covered by injury or sickness. Because of the newness of the industry and because the cooperatives were located in rural areas, rural electric cooperatives had great difficulty in obtaining insurance. The major insurers, whose business was predominantly urban, considered rural electric cooperatives as "farmers playing with electricity." The failure of the insurance community to respond to their needs was one of the principal motivations for the formation of NRECA. We are proud to say we have come a long way from the situation in those early years. Employer provided welfare and pension benefits now provide for the rural electric worker and his family upon illness, disability, death or retirement. The basic benefit programs discussed below are provided to most rural electric cooperatives through NRECA.

The typical employee of a rural electric cooperative is a 41 year old electrical worker living in a rural community. The pay standards are moderate with the average pay approximately $22,700 but the work involves a degree of risk higher than the norm for injury or death.

Medical insurance is provided to rural electric employees to cover expenses above deductible and co-insurance amounts. These coverages are essential to the participant and family for financial security in the event of illness or injury. These benefits are available to all employees of the cooperative without discrimination.

Two long term disability programs are offered: One which provides 50 percent of salary without offset for Social Security disability benefits and one which provides

66⅔ percent of salary but offsets for Social Security. In the context of electrical workers, disability benefits are particularly important because of the nature of the occupation, which involves a relatively high risk of serious job related injury. These benefits are available to all employees at the cooperative without discrimination.

Life and Accidental Death and Dismemberment insurance is provided in multiples of one to five of annual earnings. The typical employee is insured for approximately $53,000 or about two and one-third times salary. This insurance accounts for a major portion of the typical employee's estate and thus is a primary source of support for the employee's family in the event of death, often serving to preserve the family unit. These benefits are available to all employees of the cooperative without discrimination.

In addition to the basic care welfare benefits described above, some cooperatives have small amounts of short term disability, dental, vision care and business travel insurance which serve those needs.

Pension benefits are provided through a defined benefit and a money purchase pension plan. These programs are available to all employees of the cooperative without discrimination. The typical employee will receive 43 percent of his salary from the defined benefit plan as a retirement benefit. In addition the employee may receive benefits accumulated from the money purchase plan.

BENEFITS ARE DISTRIBUTED EFFICIENTLY AND EFFECTIVELY

Rural electric cooperatives are tax exempt cooperative organizations that are familiar with the advantages of the cooperative principle. It is not surprising that most rural electric cooperatives have elected to cooperatively pool their resources through NRECA to utilize their collective purchasing power. The benefits of the welfare programs are cooperatively provided through a common trust that is tax exempt under I.R.C. section 501(c)(9). Pension benefits are provided through two master multiple-employer trusts as defined in I.R.C. section 413(c). The group and master trusts exist to provide services for the insured individuals in the form of optional benefits at the lowest possible cost. The group trust utilizes self funding of its welfare benefits (except life insurance) to optimize the return to the cost of the benefit and reduce the cost of outside services to the lowest prudent level. The welfare and pension programs provided through NRECA are self-administered by professional staff. The cooperative nature of the programs encourages the cooperatives to reduce costs and prevent injury and disability by peer pressure, educational programs and professional counseling. In addition, various methods of cost sharing and provider auditing helps keep down cost and over utilization of benefits.

In the past few years our medical program has been subject to the same escalation of health care costs as other medical programs in the United States. In an effort to reduce the rapid growth of medical care costs, we began in the early 1980's to pay for home health care, ambulatory surgery and voluntary second surgical opinions. We also adopted a cost containment package (elective by the system) that provides for a hospital confinement deductible, mandatory second opinions for certain surgery and reduced reimbursement for private duty nursing. These provisions discourage unnecessary procedures and encourage patients to return home as soon as possible. When we put the cost containment package into effect in 1983 we expected it to save about 7 percent on medical costs. Our figures show that the program is a great success with savings of about 10 percent. Approximately 20 percent of our systems have adopted the package and we are encouraging the adoption of the package by a greater number of systems along with higher deductibles and sharing of the premium cost between the systems and employees.

BENEFITS ARE DISTRIBUTED FAIRLY AMONG PLAN PARTICIPANTS

The welfare and pension benefits are distributed just about evenly across the employee population. Health benefits are provided on the same basis to all participants at the time of need. Disability and life insurance benefits are provided as a common percentage of compensation to all employees. Retirement benefits are similarly provided to all employees as a percentage of compensation, factored by the length of service.

The benefits provided are adequate, but not by any standard excessive. They are designed to provide for the reasonable replacement of lost earnings or reimbursement of expenses.

TAX INCENTIVES ARE IMPORTANT IN ENCOURAGING EMPLOYER PROVIDED BENEFITS

Among employees of rural electric cooperatives, benefits constitute approximately 37 percent of gross salaries paid to employees. This 37 percent figure includes the cost of all employee benefits, both those that have incentives and those that do not. When vacation, sick leave, holidays, and other non-tax incentive benefits are excluded we find that tax incentive benefits contribute only 26 percent of gross salaries paid to employees. Of this 26 percent, approximately 16 percent consists of tax deferred contributions to pension programs. Approximately 10 percent consists of truly tax exempt medical and other similar benefits. Because the great bulk of the tax favored benefits provided to rural electric employees are pension and welfare benefits our discussion will be primarily directed towards those programs.

Rural electric cooperatives have absolutely no tax motivation themselves for providing any type of employee benefits. Rural electric cooperatives are almost all tax exempt under I.R.C. section 501(c)(12) and since tax exempt, derive no tax advantage from the provision of employee benefits. Employee benefits are provided because they serve a social purpose—the protection of the employee's health, and the provision for disability, death or retirement.

Pension and welfare benefits are provided by rural electric cooperatives as a part of an unwritten but long standing social contract among government, employers and employees whereby Social Security, Medicare and Medicaid are provided by government as a mandatory, basic portion of employee protection. A second level of protection is provided by employers on an optional basis, which government encourages by favorable tax treatment. The final portion is provided by employee savings, some forms of which are also encouraged by the tax laws.

Of course there is a revenue cost to the Treasury when benefits are provided to employees on a tax favored basis. The question is whether the cost of foregone revenue equals the social benefit derived from those foregone revenues. There is no doubt in our minds that the revenue cost of tax favored fringe benefits is more than adequately paid for by the broad participation of rank and file employees in essential welfare and retirement plans. Most of the participants in our programs are blue collar workers, there are relatively few management level or highly compensated employees. It is simply not realistic to expect the average employee to forego his immediate income needs to set aside the substantial sums needed for retirement or for his health and disability needs. It is our experience that the vast majority of employees do not protect themselves against these eventualities unless the coverages are provided by the employer. A shortsighted philosophy often prevails in which the employee elects to "take home" pay rather then prepare for contingencies of this nature. It is the employer who recognizes the need and makes the allocation of resources to employee benefits. Tax incentives represent an essential cost sharing between government and private industry to encourage the maximum availability of these benefits.

RECOMMENDATION FOR PUBLIC POLICY DEBATE

In closing, we would like to raise several issues deserving of further consideration by the Congress and the Administration as debate on the appropriate tax treatment of fringe benefits evolves.

First, and foremost is the need for a predictable and consistent policy on the tax treatment of the benefits discussed here. What was once a ten or fifteen year review and reform of the tax law has now become an annual affair. Frequent changes in the laws affecting these benefit plans adds significantly to the costs of their administration and makes planning for future contingencies difficult. If our 1,000 member cooperatives each administered their own benefit plans, we have no doubt that many would have terminated them in the face of these yearly changes. This is frequently the choice many small and medium sized businesses are faced with.

Second, we would like to state again that our benefit plans are meeting the economic security needs of our large rural electric family across the nation. When no one else would meet the light and power needs to these areas, the rural electric cooperatives did. Before there were government sponsored plans to care for the disabled employee, plans to provide for his dependents in the event of death, or plans to provide an adequate income after one's retirement, the rural electric cooperatives offered this protection to its employees. These benefits are non-discriminatory, offering a high quality of benefit at the lowest possible net cost. If we were not to provide these plans for the basic economic security of our 110,000 employees and their dependents there could be little doubt that each Member of Congress would be petitioned for similar protection to be provided by the Federal government.

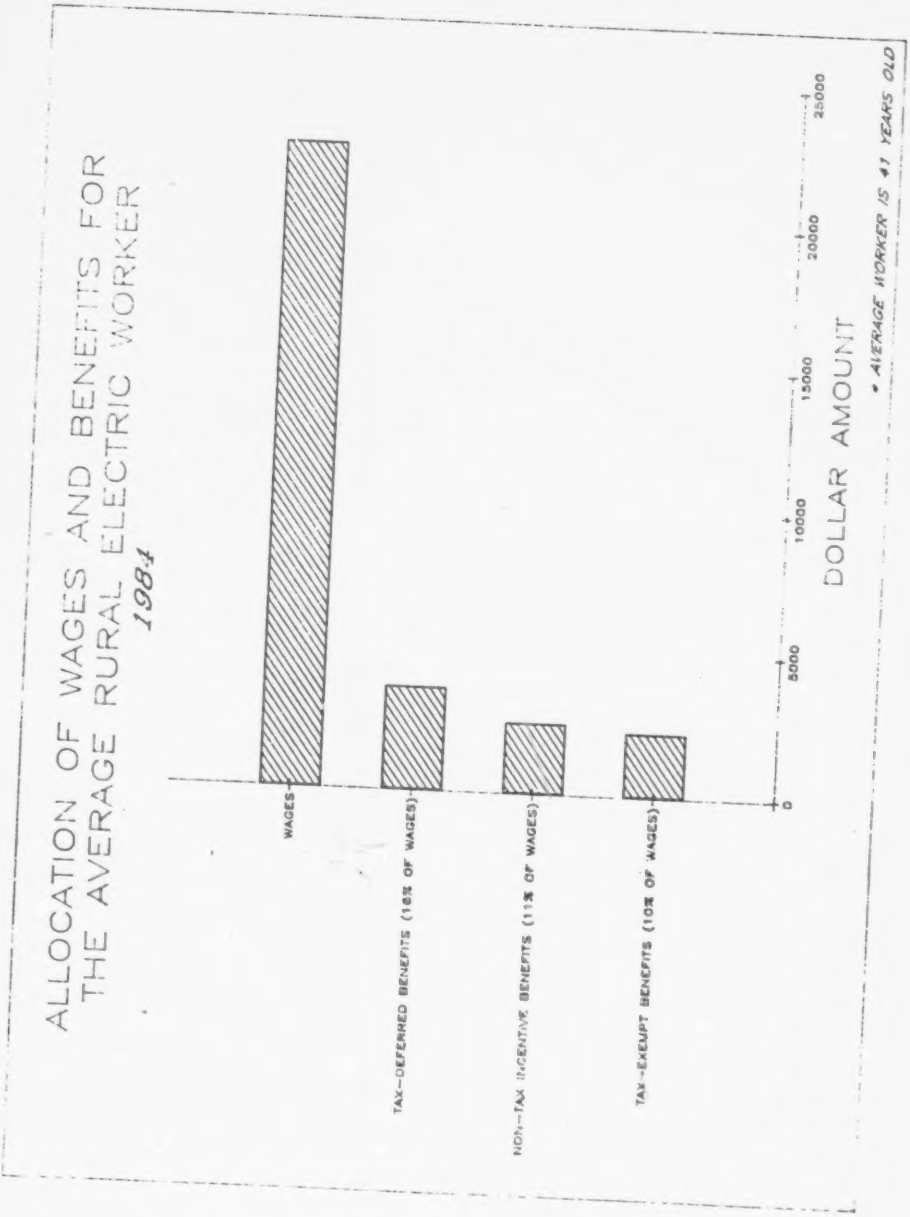
With regard to specific policy changes, we would like to recommend three proposals for your consideration in the area of salary reduction money purchase pension plans, the $50,000 limitation on the tax-free treatment of employer paid life insurance premiums, and proposals to limit the amount employers may pay in health insurance premiums.

Our national pension policy has encouraged individuals to save their retirement and has sought to make such pension benefits available to a broad spectrum of Americans. In furtherance of that policy, the Revenue Act of 1978 added section 401(k) to the Internal Revenue Code permitting profit sharing and stock bonus plans to adopt special salary reduction features that encourage employee savings. However, under present law a plan that is not a profit sharing or stock bonus plan cannot provide such a feature. The exclusion of money purchase pension plans has denied the benefits of the increasingly popular salary reduction savings programs or employees of nonprofit organizations and to employees of for-profit organizations that have no current or accumulated profits. Apparently, it was simply a matter of oversight that Congress did not extend the availability of salary reduction arrangements to money purchase pension plans. The Treasury Department has twice supported such legislation in public testimony on June 14, 1982 and September 21, 1983 before the Ways and Means Subcommittee on Select Revenue Measures. It is our hope that Congress will soon adopt legislation to promote regular retirement savings through salary reduction arrangements under a money purchase pension plan.

The present $50,000 limitation on the amount of employer paid life insurance premiums that is tax-exempt was first enacted by Congress in 1962. Since that time the cost of living has continued to increase significantly, reducing the value of this benefit today to only $14,560. As mentioned earlier, the average coverage for our employees remains at roughly two and one-third times annual salary or $53,000 per employee. It is our recommendation that Congress review the present limitation to develop a means of preserving the current dollar value of protection provided.

Finally, we would like to speak against proposals that have circulated over the last year to limit the tax-free treatment of employer-paid health insurance premiums. It has been our experience that the appropriate level of health insurance coverage is best left to the individual cooperative's management in consultation with their employees. Differences in geography, availability of health services, and job related risks would make a national standard difficult to reach and unwieldly to administer. The record of our members in developing a level of coverage adequate to meet their employees' needs and in pioneering efforts to control health care costs has been impressive. We urge the Congress to consider the use of flexible spending accounts which encourage employees to hold down costs of non-taxable benefits like health insurance, rather than impose an inequitable and unworkable cap on those benefits.

This concludes our recommendations for public policy debate and we remain available to provide this Committee or any other body with any further information that may be helpful in deliberations on these important concerns.



ALLOCATION OF WAGES AND BENEFITS FOR THE AVERAGE RURAL ELECTRIC WORKER
1984

* AVERAGE WORKER IS 41 YEARS OLD

ROCKFORD, IL, *September 5, 1984.*

Hon. ALAN DIXON,
U.S. Senate, Washington, DC.

DEAR MR. DIXON: This is to urge action in September to continue fair tax treatment for legal services plans. I am concerned that Congress will not act in time to prevent Section 120 of the Internal Revenue Code from expiring on December 31. That section provides tax treatment of qualified legal services plans similar to that of other statutory fringe benefits.

Section 120 was first enacted in 1976 on a temporary basis to see if it would stimulate the growth of legal services plans without costing much in foregone revenue. I believe Section 120 has clearly succeeded.

I am currently on the panel of "Cooperating Attorneys" for the UAW Legal Services Plan. While I am not an employee of that Plan, I accept referrals of Plan participants for legal matters not fully covered by Plan benefits. The Plan would not have come into existence if Section 120 had not been enacted.

Legal Services plans like this one are so cost effective that they can flourish as long as they are treated equally with other statutory fringe benefits. Legal services plans should not be subject to income taxation or FICA or FUTA taxes. Certainly the minimal revenue loss involved provides no basis for singling out legal services plans for harsher treatment.

I urge your strong support of S. 2080, H.R. 5361.

Sincerely,

JOHN M. NELSON.

STATEMENT OF HAL BOEL, VICE PRESIDENT, FEDERAL RELATIONS, PACIFIC TELESIS

My name is Hal Boel and I am Vice President, Federal Relations for Pacific Telesis Group. I appreciate the opportunity to submit my remarks on behalf of Pacific Telesis and its subsidiaries to the House Committee on Ways and Means. The taxation of fringe benefits is a matter that we regard as extremely important to the Corporation and to our employees.

Pacific Telesis is opposed to any attempt to tax employee benefits for many reasons. Favorable tax treatment for employer provided fringe benefits was implemented to encourage the development of benefit programs that would protect and provide for employees and their families. Employees have benefitted from these programs through better medical, dental and vision care that the great majority either couldn't or wouldn't normally be able to afford. At the same time employers have benefitted through overall better health of their employees translating to less time lost to serious or disabling disease and incidental time off for illness. In addition, employer sponsored tax favored pension plans have provided, and promise to provide, for the security of American workers past and future. No government programs approach in scope and generosity the benefits provided by employers.

The advantages of tax favored employer provided fringe benefits are clear. The advantages and motives of proposals to fundamentally change the tax status of traditional benefits are not so clear.

If the prime motive of proposals to subject benefits to taxation is raising federal revenue, the result may be the direct opposite of the intent. It is not at all clear that employers, including Pacific Telesis, would continue to provide currently available benefits if favorable tax treatment were substantially modified. Should employers not choose to continue benefit programs, there would be no benefits to tax and no additional revenue. Moreover, in the absence of employer provided benefits, the health and retirement needs of employees would become the responsibility of the federal government. According to the administration's 1985 budget submission, the federal government will spend $69.7 billion in 1985 on medicare to provide health care to roughly ten percent of Americans; the revenue loss for the tax exemption of employee provided health care coverage is estimated to be $28.2 billion for the same period, but will cover nearly 90% of Americans. Correspondingly, the federal government will provide $190.6 billion in Social Security benefits—a program that does not provide full retirement income; in 1985 the "tax expenditure" for employer provided pension plans—providing full retirement income for 75 percent of American workers—is estimated to be $80.7 billion. It is evident that the tax loss from employer provided pensions and health care, covering a greater number of Americans with more complete protection, is significantly less costly than the expenditures of corresponding government programs. Thus, the cost to the federal government could be considerably greater than any revenue enhancement produced by taxing fringe benefits.

If the intent of proposals to tax fringe benefits is directed at overly expansive benefits (in lieu of cash) or at areas of abuse, certainly corrective legislation, if needed, would be appropriately directed at specific areas. However, imposing too many restrictions can cause plan terminations and deliberalization. Management groups and owner-employees can provide for themselves through other mechanisms even though they are less tax-efficient. The real losers from overly restrictive legislation may well be the "average" employees whose coverage is eliminated and who have no adequate means of replacement. Under present law non-discrimination rules appear to be adequate. The address not only eligibility but contributions and benefits, as well as exceptions, for good faith collective bargaining. However, also under present law, if a qualified plan is found to discriminate in favor of officers, shareholders or other highly compensated class, the otherwise applicable exclusion is generally denied for all benefits provided under the plan, including benefits provided to the rank and file employees. The issue of discrimination must be dealt with in its proper perspective as it occurs. Concepts such as limiting the tax on benefits to the first 5 percent of adjusted gross income could build in discrimination by providing advantages to higher income employees. Our work force is expanding and aging and expenses are increasing. Our planning must accommodate these changes but there is no one answer. The answer does not lie, for example, in regulations that would unrealistically limit the amount of prefunding for welfare benefits. By arbitrarily limiting prefunding deductibles, the long term penalties could be severe. Abuses should be eliminated but we should stop short of removing incentives that serve a legitimate social purpose and benefit the larger class of employees. It is unrealistic to consider the wholesale elimination of programs that represent the considerable social progress made over the years. if such programs are eliminated serious consideration must be given to what will replace them. The economic security needs of individuals will not diminish and to the extent that private plan coverage does disappear, it will create pressures for government benefits to fill the gap. Expanding governmental programs beyond their current level would be wrong. Tax incentives to business represent a far more efficient method than government control. In fact, the advance funding concept of many private plans contributes to the formation of capital—a feature not available with Social Security's pay-as-you-go financing.

The removal of corporate tax incentives or the imposition of too many government restrictions on employee benefits would have a direct impact on Pacific's employees. Where tax incentives no longer exist for corporations they are faced with several choices. One such choice is the continuation of the programs with the concomitant increase in expense to the corporation passed on to the consumer. The other extreme is to discontinue the programs. It is difficult to say at this point which alternative or combination of alternatives would present the best economic choice for Pacific. Several scenarios are being studied. It is safe to say, however, that the economies of scale would make the cost of benefits less through an employer provided program than if each employee were faced with the prospect of finding comparable coverage on an individual basis. The cafeteria plan concept, which Pacific Telesis has incorporated into its benefit plan for its subsidiaries, represents a move toward an effective compromise and ultimate cost containment wherein the user is required to assume some of the overall costs of care that is more custom tailored to meet individual needs. The incentive for companies to pursue this kind of creative planning should not be discourage by removing the design flexibility that exists today.

What we need is a stable national policy. Since ERISA was enacted into law 10 years ago, we have had two major Social Security amendments, legislation on age and sex discrimination, revisions on plan termination liabilities and seven major tax acts. In such an environment it becomes extremely difficult and expensive to design plans and appropriate support systems. Without a meaningful, stable policy that will exist for a reasonable period of time, employers will be hesitant to make positive changes in plan design and management. In fact many may choose curtailment or abandonment, moves that can only penalize average employers, rather than deal with unnecessary, expensive and difficult administrative burdens and the uncertainty of change.

In Summary, Pacific Telesis urges congress to consider the full impact of wholesale elimination or restriction of tax incentives on employees benefits before deciding that this is the only answer. Congress and the administration must develop a thoughtful, coordinated policy that employers and employees can rely on in the future. I believe that responsible planning of programs, based on some stable, national policy, with directed corrective action taken on obvious abuses, can achieve the purpose for which these incentives were originally designed. At the same time these efforts, if managed properly, can ultimately reduce costs for all concerned, including government. What we are spending for our employees to have the opportunity to participate in employer provided benefits should be closely scrutinized and carefully managed so that it serves a legitimate and cost effective purpose. Benefit programs are necessary, but the assumption that corporations like Pacific will continue to offer them without cost incentives to do so could be an erroneous one and one that needs more in-depth analysis of the long term impact.

PFIZER INC.,
New York, NY, September 19, 1984.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
House of Representatives, Washington, DC.

DEAR MR. SALMON: I am writing to you in connection with the House Ways and Means Committee's hearings on employer-provided benefits. Specifically, I believe that there are several key issues in this area which must be carefully reviewed from the perspective of the employee, the employer, and of the Government.

Over the years Congress has protected American workers through various statutes and regulations governing employee benefit plans. For example, the Employee Retirement Income Security Act of 1974 ensures, among other things, that employer-sponsored benefit plans do not favor the highly-paid employees. We are at a point, however, where there is a risk of regulating employer-sponsored benefit plans out of existence if the tax treatment accorded employers sponsoring these plans is made less favorable.

Tax laws should be structured to encourage employers to sponsor benefit plans that are made available to broad-base groups of employees. Current tax laws provide these incentives and, in addition, provide adequate safeguards to ensure equality of treatment for all employees participating in these plans. Since a balance between providing incentives to employers and providing equal treatment for employees has been created and maintained effectively by existing legislation, I believe that it would be unwise to adopt more restrictive measures. Therefore, it is important to review the consequences that might result if this balance is changed.

Currently, the costs of most employer-provided employee benefit plans are deductible by the employer. This affords an important incentive to employers to continue to maintain the plans. Increased taxation and regulation in this area can result in employers' decisions to terminate certain benefit plans since it would therefore be far easier to provide the equivalent cost of the benefits as direct compensation to the individuals involved. This can result in unfortunate consequences for the vast majority of American workers.

For example, the current cost to Pfizer of providing medical and dental insurance is $2,300 per employee per year. This represents approximately 11%of the average base pay of our non-exempt employees versus less than one-half of one percent for the highest-paid employees. If Pfizer were to terminate its medical and dental plans and to add the $2,300 to the pay of each employee several unfortunate results might obtain:

There is no guarantee that all employees would necessarily use the money to purchase substitute medical and dental coverage. Hence, there is the possibility that a number of employees may be faced with severe financial hardships should they or their families incur significant medical or dental expenses.

Since Pfizer, like most employers, provides coverage for large numbers of employees, it can obtain more favorable rates for this coverage than individuals seeking to purchase similar coverage. Therefore, even *if* we could rely on employees to purchase substitute coverage on their own, it would cost each of them far more to obtain the comparable insurance coverage. Thus, this may be an incentive for employees to refrain from purchasing medical and dental insurance. Even if they do purchase it, however, the $2,300 may not purchase enough to afford them adequate levels of protection.

Some might wonder then whether the Government could provide these same benefits directly at lower costs. To answer this one would merely have to review the escalation of costs in the private sector versus the greater rise in the cost of government-sponsored programs.

We have strongly supported President Reagan's advice that American workers be provided with incentives to save for their retirement years. Currently we provide an ideal vehicle for this in both the Pfizer Savings and Investment Plan and our U.S. Savings Bond program. In the former, employees may save up to 15% of their pay each year. To provide a strong incentive for employee savings, Pfizer provides a matching contribution—$1 for each $1 on the first 2% of an employee's compensation, and 50¢ for each $1 on the next 4% of an employee's compensation contributed.

This employee savings incentive has produced noteworthy results—over 90% of our employees participate in this plan. If the current tax treatment of employee benefit plans is altered, employees may be forced to utilize monies they currently can afford to save to purchase heretofore employer-provided benefits. As a result, participation in the Savings Plan may decline—even to the point where the IRS removes its qualified status because the only participants left will be the most highly paid.

We at Pfizer have always maintained an egalitarian approach to employee benefits—every employee is covered by the same benefit plans. Our most highly paid employees could probably replace whatever coverage tax changes force us to remove but the vast majority of our employee may not be able to replace this coverage. It is precisely for these employees that our benefit plans were implemented, and it is these employees who will be harmed should the private employee benefit system be changed in the way proposed.

Accordingly, we would urge that the law not be changed to treat the employer-paid cost of life, disability, health care, pension or other benefits as income to employees, or to eliminate the deductibility of companies' expenditures for such payments.

Sincerely,

EDMUND T. PRATT, Jr., *Chairman of the Board.*

PICKER INTERNATIONAL,
Northford, CT, September 13, 1984.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
House of Representatives, Washington, DC.

DEAR MR. SALMON: Code Sec. 127 which expired for tax years beginning January 1, 1984, provided that employee benefits under an employer's nondiscriminatory educational assistance plan were not includable in an employee's gross income and gave employers an incentive for tax years 1979 through 1983 to add an educational assistance plan to their fringe benefits package. In addition, the payments were not subject to FICA, FUTA, or Federal Income Tax Withholding.

Congress did not act to extend this provision beyond the January 1st. expiration date before it ajourned last fall, and consequently, the payments became subject to FICA, FUTA, and Federal Income Tax Withholding.

The Senate added a provision to the Tax Reform Bill, H.R. 4170 that would have extended the program to taxable years beginning before January 1, 1986. However, the provision was deleted from the bill in conference. The Tax Reform Act of 1984 (Public Law 98-369) contained no extension, and as a result, educational benefits unrelated to employment are still subject to FICA, FUTA, and Federal Income Tax Witholding.

It would be in the best interest of Government to reinstate the benefits under educational expense plan as nontaxable to the employee for FICA, FUTA, and Federal Income Tax Withholding. One of the Governments responsiblilities is to seeing to a better educated public. When a company offers a benefit for an employee to better themselves, the Government should continue to back up the public. Not take away an important responsibility of the Government and private sector working hand in hand to advance the people who would take advantage of the educational assistance plan. This is a very poor way for the Government to create a very small revenue producing plan.

It is still possible that you can help by extending the provision retroactively to January 1, 1984. I appreciate your anticipated cooperation in helping to pass the above educational assistance plan to have more people pursue their educational goals under Code Sec. 127.

Yours Truly,

RUSSELL SPECTOR, *General Accounting Manager.*

SOUTHWESTERN BELL TELEPHONE,
St. Louis, MO, September 20, 1984.

Mr. JOHN J. SALMON,
Chief Counsel, Ways and Means Committee,
Longworth House Office Building, Washington, DC.

DEAR MR. SALMON: I would like to take this opportunity to express Southwestern Bell Telephone's interest in the work of your subcommittee(s). Southwestern Bell Telephone recognizes the tremendous impact of employee benefits on national social goals and tax policies as well as its effect on individual financial well-being.

Southwestern Bell Telephone presently provides financial protection through our benefit programs to over 70,000 employees and to another 25,000 retirees, former employees, and their beneficiaries. A much larger number of people are dependent on these 95,000 people for their financial security.

Our benefit programs are structured so that 99.4% of our pension and benefit expenses in 1983 were incurred on behalf of lower and middle level employees. When combined with Social Security, our pension benefits provide a larger percentage of pre-retirement income to lower paid employees. Therefore, changes in the tax status of employee benefits will significantly affect the majority of our benefit plan participants and their dependents.

Southwestern Bell Telephone provides a comprehensive program of benefits. Favorable tax treatment has undoubtedly contributed to the steady expansion of our employer-provided "security net" over the past 71 years since the establishment of our first benefit plan. Without tax incentives our Company would question the advisability of incurring the substantial administrative expenses associated with employee benefit programs. We could deliver the same amount of total compensation to our employees in wages with lower administrative costs to the Company. I think it is safe to say that many employees would not use such increased wages to provide retirement income or to provide protection for health expenses or disability. These same people would then most likely request additional services and protection from state and federal programs.

Given consistent, long term tax treatment by the federal government, Southwestern Bell Telephone feels strongly that we, in conjunction with collective bargaining representatives, can best plan for the financial security of our employees. We think these programs clearly further worthwhile social and economic goals in this country. On behalf of our employees and retirees, I urge that you preserve the traditional tax status of employee benefits.

Sincerely,

J.F. HAAKE, *Vice President.*

STATEMENT OF JANE BARBER, BENEFITS MANAGER, TEKTRONIX, INC.

SUMMARY

Federal tax policy in conjunction with employer self-interest in offering benefits as part of a human resources strategy, have fostered the development of privately-managed social programs which have done this country, its communities and its citizens a great deal of good over the years. Before further changes are made to the tax codes which have stimulated the formation and continuation of benefit plans, Tektronix urges Congress to step back and consider what it wants social policy to be during coming years.

We believe the policy should be one that fosters self-responsibility and provides options which will make it attractive for people, in conjunction with the employers for which they work, to make wise personal decisions and to plan and save for their own financial futures. Examples of how these goals can be achieved at 401(k) cash or deferred plans and Section 125 cafeteria plans.

"Cafeteria" benefit programs have, in our opinion, the potential to provide long term solutions to some problems created by the more traditional design of benefit plans. We believe they will enable us to better manage our benefit costs, foster a sense of self-responsibility on the part of employees and better meet the needs of a diverse work force. In particular, we look forward to a cafeteria benefits plan helping us with our strategy to restrain increases in the cost of health care.

INTRODUCTION

Mr. Chairman, my name is Jane Barber. I am the Benefits Manager for Tektronix, Inc., headquartered in Beaverton, Oregon. In that role, I am responsible for designing and administering the company's benefit program.

Tektronix is Oregon's largest private employer with more than 15,000 employees. We also employ 2,000 people at our Clark County facility near Vancouver, Washington and another 1,900 people at sales and service offices in 29 states.

Tektronix is an electronics company that manufactures sophisticated test and measurement equipment, television products, computer graphics terminals and peripherals, and computer-aided design equipment. Our total sales in the fiscal year just completed were $1.3 billion. To be successful in our chosen market and to generate the profits from which tax revenue can be derived, we must attract, retain, and motivate high-performance employees. They are our most important resource. They create the product ideas, they design the products, they manufacture the products, and they represent the product in the marketplace.

Benefit programs as part of human resources strategy

Tektronix believes benefit programs have an important role to play in helping us to have high-performinig employees. Along with cash compensation, they form a part of the package which attracts employees to our company and through which we reward performance. They help our employees be more productive by relieving them from worry about what the financial consequences for themselves and their families would be if they were to incur large medical or dental bills, or the loss of income through disability or death. Company provided education programs assist employees to increase their potential and to adapt to changing job requirements, so they may continue to be an effective part of a high-performing team. We have a profit sharing program and an employee stock purchase program, which provide productivity incentives and allow employees to share collectively in the success of the company.

Social and economic implications of benefit programs

The tax policy of the United States, as well as employer self-interest in offering benefits as part of a human resource strategy, have fostered the development of privately managed social programs which have done this country, its communities, and its citizens a great deal of good over the years.

Through employer-offered health insurance programs, families have been kept from becoming destitute as a result of medical bills for serious illness or injury. And, through the affordability of good medical care, people have been restored to good health and productive lives. Through disability income insurance programs, combined with health insurance programs, employees who became so disabled they could no longer work have been able to maintain a reasonable standard of living without turning to their communities for charity or to government for more assistance. Group life insurance programs have replaced income for families of deceased wage earners for a transitional period until they were able to restructure their lives and find other means to provide for the family.

There is, of course, a cost for these programs. In the fiscal year just ended, Tektronix spent $26 million of its sales on health, life and disability income programs. Because these programs are tax deductible for the company and tax-exempt for employees, the government shared in this cost. However, I believe this was a cost-effective expenditure for the government, assuming the social needs should have been met somehow.

To provide an example which I know is over-simplified but which illustrates the dynamics, last year my company spent $26 million on benefit programs, and the government lost revenue of approximately $12 million. If we assume that the government, instead of Tektronix, had provided the same $26 million to meet the security needs of our employees, then it could be concluded that Tek would have lost a tax deduction of $26 million which would have yielded the government increased revenue of $12 million. The net effect for the government would have been a loss of $14 million. This would seem to be the wrong direction for a country seeking to reduce its deficit. What would have happened if the company's contribution to these programs had been taxable income to employees? In the short term, the government's share of the cost would have been reduced to something less. However, there are problems with this approach. Even now, we have employees who receive more than $50,000 in life insurance calling us and saying, "Look, if I've we got to pay tax on that amount, I'd rather have it in cash." If all benefit contributions created taxable income to employees, I think it's fairly predictable that more and more employees would begin to pressure their employers to give them cash instead of benefits.

That might be fine from the point of view of raising revenues, but it would encourage people to take risks with their security. When they then fell ill, became disabled or died, society would have to develop the means to take care of them and their families. In short, taxation of these benefits might create short term revenue solutions, but it most certainly would create long term social problems. Another factor which must be considered is that the money Tektronix spent on those programs last year did not just go down a drain never to be seen again. In the case of the health, life and disability programs, it was paid out in benefits to persons who purchased goods and services, which in turn, helped maintain or broaden the tax base from which the government derived revenue. To the degree it contributed to the success of businesses or institutions who buy Tek products, some part of it will come back to Tek in the future.

Despite the good these programs and the other social programs of the United States have done over the years for individuals, employers, communities and the country, I also believe they have created some problems through their structure and design. They have shielded people from the economic realities of life, much in the same way as a parent does who pays all the bills a teenager runs up. As a result, they have stimulated some undesirable results: uncontrolled costs, particularly in the case of health insurance; an expectation that government or employers have an obligation to keep providing more benefits; and a minimal understanding on the part of individuals that they have a responsibility to participate in providing for their own security. Just as the current design of programs, with their attendant messages, have created certain behavior and attitudes, I believe redesigned programs and appropriate tax incentives can do their part in creating improved results.

The legislation that enabled Individual Retirement Accounts and 401(k) cash or deferred plans are excellent examples of how tax policy can stimulate positive behaviors and desirable social goals. More people are now saving for their retirements and feeling proud of themselves for doing so. These programs are fostering independence and a sense of self-responsibility. The money which is being saved on a tax deferred basis is being plowed back into the economy through investment and is broadening the tax base for national, state and local programs. They do not foster the notion that people have a "right" to total economic security from the government or employers, which creates dependent behavior and an appetite which can never be appeased. Instead, these programs send a message that the government believes it's good for people to help themselves.

"Cafeteria" benefit plans and cost management

Another piece of legislation which I believe to be capable of providing some solutions to the problems created by the traditionally designed programs is that which enabled "cafeteria" benefit plans. My company has just completed a year-long study of our benefit program for the purpose of identifying changes which would enable better cost management, better meet the needs of our now diverse workforce, and better foster a sense of self-responsibility on the part of employees. And, we wanted to do these things while enhancing employee relations. It's our conclusion that a cafeteria benefits plan will allow us to meet our objectives, while still assuring that the positive social purposes of current programs will be continued.

The essence of the program we plan to design and implement is to create benefit "credits" by shrinking the portion of the program which employees automatically receive down to a minimum core. These credits can then be used to purchase the same benefits they have now, a different combination of benefits which may be more appropriate to their needs than the company-designed program has been, or they may trade them for cash. Conversely, they may spend some of their cash compensation to buy additional benefits (instead of asking the company to provide additional benefits). The core would assure that all employees still had some level of financial security, and that social purposes would be met. Also, the tax exempt nature of the benefit options, as opposed to the cash option, will provide employees with an incentive to continue reasonable levels of insurance protection.

This approach to benefits helps employees better understand there is a cost to benefits, and it sends a message that employees have a personal responsibility for identifying and planning for their own financial security. It also enhances cost management in several ways. The company will be able to set a limit on how much it will spend on benefit programs each year, instead of automatically absorbing whatever expense is generated by our current commitment to pay 100% of the cost of various plans. It will allow us to help meet new benefit needs, such as child care assistance, without necessarily adding to the total cost of our program. And, employees will have financial incentives to become better consumers of benefits, especially health care benefits. They will have a choice of health plans, with varying amounts of "first dollar" cost for incurred health care expenses, as well as varying costs for buying the insurance. If they choose a less expensive option than the plan we now offer, they may buy other benefits or receive cash. We believe this power of decision and the opportunity to receive cash will begin to cause people to be more cost-conscious and self-responsible consumers of health care services. We expect this, over time, will reduce the current demand on the health care system for all of the most expensive kinds of services that are available. We even hope it may begin to motivate people to take better care of themselves, since people staying well is the ultimate health care cost management strategy. As a companion to offering financial incentives to use the health care system more wisely, we will be providing employees with a great deal more information than we have in the past to help them know how to do so.

While on the subject of health care cost management, I'd like to say a few words about the strategy of putting a cap on the amount of tax-exempt contribution a company can provide for an employee's health insurance. It is my opinion this would do little or nothing to control the cost of health insurance. It would simply add to an employee's taxes, without doing anything to solve the underlying problems. It would be similar to a company deciding to solve its health cost problems by simply shifting more expense to employees. It would aggravate the employees without providing a way for them to help find solutions or to lower their expenses. It might increase revenues slightly, but then the government would be in the strange position of hoping health care costs didn't go down, because if they did, revenues would be reduced.

CONCLUSION

Congress must draw its own conclusions about the social value of benefit plans provided by the employers of the U.S. and how to structure tax policy. It is my strong recommendation, however, that Congress decide what it wants the social policy of the United States to be before more changes are made to the laws which have stimulated the formation and continuation of the plans serving social needs.

My personal belief is that the policy should be one that fosters self responsibility and provides options which will make it attractive for people, in conjunction with the employers for which they work, to make wise personal decisions and to plan and save for their own financial futures. Through this partnership of government, employers and employees, a vast segment of our population will have financial security when serious illness strikes, when wage earners become disabled or die, and when the day for retirement arrives. Through employer-sponsored plans, the government is relieved of the need to provide for these same life events which occur in every family at some time. By fostering a notion of self-responsibility, I believe people will feel more involved in their own futures, which in turn will play its role in helping this country of ours to be more productive and competitive in the world market place.

My personal experience in trying to redesign my company's benefit program to meet current and future needs, I know that the only way to sensibly decide what changes ought to be made is to step back and ask, "What are our objectives?", "How do we want people to behave?" "What are the alternative objectives?" Once you've answered those questions, it becomes clearer how to structure the programs and where to place the incentives and disincentives.

Tektronix thanks you for this opportunity to testify.

STATEMENT OF JOHN F. TROY, VICE PRESIDENT, GOVERNMENT AFFAIRS AND TRADE ASSOCIATIONS, THE TRAVELERS INSURANCE COS.

The Travelers Insurance Companies are pleased to have the opportunity to submit a written statement to the subcommittee on Social Security and the Subcommittee on Select Revenue Measures as they consider tax policies affecting fringe benefits. We applaud the efforts of Chairman Pickle, Chairman Stark and the subcommittees to carefully analyze the implications of this issue which is of critical importance to millions of workers and their dependents.

The Travelers is in a unique position to comment on the beneficial uses of employee benefit programs. As an employer of nearly 30,000 people across the country, we offer our own employees numerous life, health and pension benefits. In 1983, the Travelers contribution to its employee benefit package was over $237,000,000, which amounted to nearly 74 percent of the cost of all benefits.

In addition, the Travelers is among the largest insurance companies in the United States. We not only sell policies to individuals, but also underwrite benefit plans for all sizes of employers from international corporations to local small businesses. Our standard practice is to cover all eligible employees or members of a group. The eligible persons are typically all full time employees who have been employed for a minimum period, such as three months, without regard to age, sex or salary level. Based on 1983 data, the Travelers provided 15,637,000 of our clients' employees and their dependents with medical insurance, took in $4.6 billion in premium and equivalents and paid over $4 billion in claims. Our life insurance policies covered 4,663,000 people, premium volume was over $478 million and claims paid were worth $433 million. The Travelers pension programs covered over 1,000,000 retirees, paying out $1.4 billion in benefits while taking in $3.1 billion in premiums. Disability insurance plans, including weekly indemnity and long-term disability benefits, provided nearly 3 million beneficiaries with over $167 million in payments. Total disability premiums amounted to $220 million.

These roles as both a large employer and a major insurance company enabled us to draw on a large bank of experience in developing our position on fringe benefits. The Travelers supports continuation of the existing system of fringe benefit taxation under which the private sector has been a vital source in effectively providing benefits. Without question, the provision of life, health, disability and pension benefits is essential to the economic welfare of the employees, dependents and retired persons covered.

Employment-related benefits can be traced back to their origins nearly a century ago. A number of private employers and some public entities offered pensions and other benefits before the turn of the century. The creation and growth of these benefits naturally evolved as the work force became increasingly industrialized and specialized. This evolution cannot be attributed chiefly to tax advantages offered to employers or employees, since much of the early development occurred when there was no personal income tax or when it applied to a very few at low marginal rates. Instead, employee benefit plans developed as a means of providing economic security for employees and their dependents in the event of premature death, disability, illness or unemployment.

The benefit plan mechanism continues to flourish even more under current tax policies since it still provides the most efficient and economical means to offer employees financial security. The informal partnership between the Government, employees and employers that now exists has been extraordinarily successful in developing programs that are effective, responsive and least costly to a huge portion of the population.

The great majority of fringe benefits, such as pensions, medical, hospital and disability payments, serve important societal purposes. These benefits supplement Social Security and welfare payments, relieving the burden on these public systems to a signficant degree. In addition, a number of forces have traditionally worked to restrict the growth of savings. Installment credit, advertising, periodic high levels of tax rates and inflation have encouraged current consumption of goods rather than accumulation of savings for retirement. Benefit plans within organizations, such as the Travelers, offer employees the effectiveness and ease of the group savings approach in providing financial security for retirement. Furthermore, as health care costs have been skyrocketing, the private sector has been actively working to keep these costs affordable for everyone involved. Businesses have been encouraging greater employee involvement in holding costs down by instituting preventive health programs and requiring payment of deductibles.

In addition, the group insurance mechanism is of immeasurable value to the many employees who, for various reasons, would be unable to obtain individual life or health policies. Through the use of group, rather than individual underwriting, these people become eligible for insurance coverage. In the event of a financial loss, the employees turn to their fringe benefit plan rather than to the Government for public assistance.

The vast majority of employers do not abuse the employee benefit mechanism. In only a few instances have employers unfairly used the tax laws to benefit themselves in a disproportionate manner. Congress can easily remedy any improper practices without destroying the majority of fair and healthy benefit programs.

Unfortunately, it appears that some Members of Congress are laboring under the misconception that benefit plans are designed to add to the incomes of the rich and therefore cost the Treasury substantial losses of revenue. However, nothing could be further from the truth. Group health benefits supply, in general, the same amount of coverage for employees of low, middle and high incomes. In fact, our experience at the Travelers demonstrates this point. Over 27,000 of our 30,000 employees participate in the Travelers contributory group life and health plan. Of these 27,000 plan participants, nearly 96 percent have salaries between $10,000 and $50,000.

These middle and lower income employees comprise the vast majority of the plan's beneficiaries and are receiving the same benefits as the small percentage of employees with high incomes. It seems clear that reduction in extent and use of benefit plans caused by changes in tax laws would have more of an adverse impact on lower income employees than on those with higher incomes.

The Travelers benefits plans are applied equally and benefit all employees. Like the group insurance plan, 96 percent of the employees participating in our retirement plan and savings and investment plan have salaries between $10,000 and $50,000. In order to make certain that our retirees can maintain their standard of living, the Travelers retirement plan contains a cost-of-living adjustment. Each retiree who has been retired for one calendar year will receive a cost-of-living adjustment to an annual maximum of 3 percent based on the Bureau of Labor Statistics Consumer Price Index. In 1980 all of our retirees received an extra economic adjustment of 2 percent per calendar year of retirement.

Instituting a tax on employee benefits would work severe consequences on all of the parties involved.

First, employers are now able to purchase insurance coverage at better rates than employees could buy on an individual basis. This factor, along with the tax incentives provided by existing laws, allows employers to provide benefits at prices employees can afford. Increasing the cost of benefits through changes in the tax would prohibit employers from continuing to provide the same level of protection.

Second, making fringe benefits taxable income to employees would represent a hardship for them, particularly those in middle and lower income brackets. Those employees who choose to stay in the group plan would face higher insurance costs due to the taxation of their benefits. In addition, employees remaining in the plan would eventually face higher costs in the form of rising premiums and deductibles as the group insurance plan is weakened by adverse selection. Adverse selection would result as healthy employees unable to meet their rising insurance expenses drop out of the plan. Those employees who do leave the group plan would find prices for individual policies even more prohibitive than their employee plans due to the lack of group underwriting advantages. For example, Travelers cost per employee for all benefits during 1983 was $8,476. If an employee tried to purchase this coverage on an individual basis, the cost would be substantially higher since the economies of group rates would be lost.

Finally, the government would be pressured to increase its responsibility to provide assistance through public programs. Employees who drop their group coverage because of prohibitive costs or because they are healthy and decide to take the risk they will remain healthy could become public charges. The pressures of additional people requiring public assistance would be an extraordinary burden on the government. The consequences of these welfare pressures on the government could be disastrous, particularly in the face of Federal and State budget deficits and the fiscal difficulties plaguing medicare, medicaid and Social Security.

At a time when Federal funds are moving away from supporting benefits, it does not make sense to discourage reliance on private sector benefit plans. Instead, efforts must be concentrated on incentives to encourage private plans to develop and cover as many people as possible.

These distinguished subcommittees have been presented with the complex task of analyzing the economic effects of fringe benefits on the Federal tax base. It is our firm belief that taxing employee benefits would not resolve the Federal deficit problem but would only create new problems. The repercussions of taxing benefits would be so widespread that the issue deserves intense review over an extended period of time rather than experimental quick-fix approaches.

Only in this way will a national policy be developed to continue to provide short- and long-term economic security to employees and their families. While the system does contain some gaps in coverage, it can be fine-tuned with minor adjustments. We believe that the extent of the employee benefit plans in the United States is a national resource which should be nurtured and improved, including changes resulting from a complete review of existing laws. It would be unfortunate, to say the least, if a fair, effective and efficient system of providing benefits for millions of people were to be abruptly dismantled.

STATEMENT OF THOMAS C. WALKER, CLU, DIRECTOR, PLAN OPERATIONS, AGRI INDUSTRIES RETIREMENT COMMITTEE, DES MOINES, IA

SUMMARY

(1) Statement limited to retirement plans.

(2) Retirement plans covered by Mr. Walker's statement cover 3,739 individuals with four (4) plans.

(3) Over 80% of participants earn less than $24,000 annually and 98% earn less than $48,000.

(4) Comparison charts show AGRI plans replace pre-retirement income at rates favorable with amounts stated as desirable by the President's Commission on Pension Policy, 1980.

(5) Restatement of the Treasury Department's estimate of 83% loss of revenue due to pension related tax deferrals accounting for lifetime collections.

(6) Personal savings aspects of pension plans compared with IRA savings by income groups.

(7) Chart distinguishing between legally required benefits, fully taxable benefits, tax-deferred benefits and tax exempt benefits showing distortion created when lumping "benefits" into a single category and assuming a tax loss on the total.

(8) Table of discretionary tax favored employee benefits, by specific tax treatment, showing proportion of wages and salaries so allocated to be much less than popularly believed.

(9) Table of Analysis G, Budget of the United States Government, Fiscal Year 1985–must be weighed against the benefits to society.

(10) Comparisons over time of numbers of workers covered—and corresponding impact on total costs.

(11) Distribution of benefits by employee income categories (over 75% go to employees earning less than $20,000 annually).

(12) Use of 401(k) to control employer pension costs.

(13) Conclusion: Current law by-and-large serves society well in that the people most needing the benefits are getting them (75% of pension participants and 80% of health plan participants earn less than $20,000).

STATEMENT

My testimony will be restricted to the retirement plans we make available to local co-ops (farmer owned grain elevators and processing plants) for their employees. The total number of people presently eligible for benefits is 3,739, including currently employed (3,007), retirees receiving benefits (463), spouses of deceased participants receiving benefits (60), and terminated employees with vested benefits (209).

In order to meet the needs of employers ranging in size from two (2) employees to over four hundred (400), we maintain four (4) plans for the local co-op board of directors to choose from. Two are defined benefit plans (one that the employee contributes to as well as the employer, and one that is 100% funded by the employer) and two are defined contribution plans (one is a pure profit sharing plan and one is a thrift/savings plan).

A total of 145 local cooperatives have their retirement plans with us as follows:

AGRI RETIREMENT PROGRAM, APR. 1, 1984

AGRI plan	Number of participating cooperatives	Number of participating employees
Contributory retirement	67	1,436
Noncontributory retirement	76	2,200
Thrift/savings plan[1]	77	1,576
Profit sharing plan	1	89
Total	221	5,301

[1] 76 of the employers in this category have two plans and are also included in the noncontributory numbers. This means only 14 of the employees in this plan are not duplicated. The thrift/savings plan is optional for most employees and approximately 71 percent contribute on an after-tax basis.

The employees covered under our plans fall into the following income categories:

Income	Total by category		Cumulative total	
	Number	Percent	Number	Percent
0 to $9,000	70	2.4	70	2.4
$9,001 to $12,000	165	5.5	237	7.9
$12,001 to $17,999	1,007	33.5	1,244	41.4
$18,000 to $23,999	1,191	39.6	2,435	81.0
$24,000 to $29,999	313	10.4	2,748	91.4
$30,000 to $35,999	129	4.3	2,877	95.7
$36,000 to $47,999	71	2.4	2,948	98.1
$48,000 to $59,999	42	1.4	2,990	99.5
$60,000 to $89,999	13	.4	3,003	99.9
$90,000 plus	4	.1	3,007	100.0

As you can see, over 80% of the participants earn less than $24,000 annually and 98% earn less than $48,000. Only 13 employees earn over $60,000 and only four earn above $90,000.

These numbers become very significant when placed side-by-side with the myth that "benefit programs are only good for the wealthy."

The following table shows the amounts required to replace pre-retirement income after retirement for married couples retiring in 1980:

RETIREMENT INCOME EQUIVALENT TO PRERETIREMENT INCOME FOR MARRIED COUPLES RETIRING IN 1980

[Selected income levels—reduction in expenses at retirement]

Gross preretirement income	Preretirement taxes		Disposable income	Work related expenses [3]	Savings and investments		Net preretirement income
	Federal [1]	State and local [2]			Percent	Amount	
$6,000	$549	$29	$5,922	$355	0	0	$5,567
$10,000	1,311	133	8,556	513	3	$251	7,786
$15,000	2,550	310	12,140	728	6	728	10,684
$20,000	3,968	520	15,512	931	9	1,396	13,185
$30,000	6,986	1,061	21,950	1,317	12	2,634	17,999
$50,000	15,202	2,622	32,176	1,931	15	4,826	25,419

[1] Federal income and social security (OASDHI) taxes.
[2] Based on State and local 1978 income tax receipts which were 19 percent of Federal income tax receipts. Does not include property tax.
[3] Estimated as 6 percent of disposable income.

Source: Preston C. Bassett, consulting actuary, President's Commission on Pension Policy, 1980.

Net preretirement income	Post-retirement taxes [1]		Equivalent retirement income	
	Federal income [2]	State and local [3]	Dollars	Ratio
$5,567	0	0	$5,576	.86
$7,786	0	0	7,786	.78
$10,684	0	0	10,684	.71
$13,185	0	0	13,185	.66
$17,999	53	10	18,062	.60
$25,419	1,651	314	27,384	.55

[1] Post retirement taxes are on income in excess of social security benefits which are nontaxable. Retirees without social security benefits would need higher replacement ratios.
[2] Federal income and social security (OASDHI) taxes.
[3] Based on State and local 1978 income tax receipts which were 19 percent of Federal income tax receipts. Does not include property tax.

Source: Preston C. Bassett, consulting actuary, President's Commission on Pension Policy, 1980.

When combining one of our defined benefit plans with social security, the following results are achieved:

AGRI INDUSTRIES RETIREMENT PLAN AND SOCIAL SECURITY REPLACEMENT RATIOS FOR A PARTICIPANT RETIRING AT AGE 65 IN 1982 WITH 25 YEARS OF CREDITED SERVICE

Gross preretirement income	Benefit as a percentage of gross preretirement income					
	Contributory plan	Social Security	Total	Noncontributory plan	Social Security	Total
$10,000	34	55	89	20	55	75
$15,000	37	48	85	20	48	68
$20,000	38	40	78	22	40	62
$30,000	39	27	66	25	27	52
$50,000	40	16	56	27	16	43

Contributory Plan benefit formula is 1.1% of average monthly earnings up to $400 plus 1.65% of average monthly earnings in excess of $400, all multiplied by years of credited service.

Noncontributory Plan benefit formula is .8% of average monthly earnings up to $1,250 plus 1.2% of average monthly earnings in excess of $1,250, all multiplied by years of credited service.

The Noncontributory Plan is used in conjunction with our Thrift/Savings Plan by all the employers who installed this particular defined benefit plan. This means the employees have the option of enhancing their retirement income by setting aside up to 6% of their W-2 earnings on an after-tax basis. The employer matches either 25% or 50% (the employer chooses one for all employees) of the amount set aside by each employee who chooses to participate. The numbers above for the Noncontributory Plan do not include any Thrift/Savings enhancement.

What do these number really mean? They mean that Congress should be thanked for writing laws that have helped to improve the economic security of every single one of the people served by our plans, and the millions of participants and beneficiaries of plans all over our great nation. This is particularly true since programs such as ours, are truly serving the middle and lower income population. Referring back to the table showing our benefits in concert with Social Security, it is quite obvious that our people would see a reduction in post retirement income of 20 to 40% without one or the other of our plans being in place. This shows very clearly that benefits do not principally go to the highly paid and workers will suffer if employer sponsored benefits do not exist.

We also understand the dilemma faced by our elected representatives in Congress who must deal with the out-of-control growth of our national debt. They must look at all possible sources of revenue and would be open to criticism if they did not. Accurate information is essential and also sometimes very difficult to find. One piece of information I have a problem with is the Treasury Department's number on tax losses for pension related tax deferrals. I believe they are overstated. Treasury statistics imply that 83 cents out of every deferred dollar is permanently lost, with the other 17 cents accounted for by current tax payments by retirees. When examined in a lifetime context, the proportion of deferred taxes lost to the Treasury ranges from 14 cents out of every dollar to 40 cents, depending on whether or not one adjusts for inflation and interest on deferred taxes and the interest factor used.

PENSION-RELATED TAX DEFERRALS LOST TO THE TREASURY

[In percent]

Method used	Taxes lost	Taxes deferred
Treasury method	83	0
Lifetime method:		
Nominal dollars [1]	14	86
Real dollars [2]	28	72
Discounted for interest: [3]		
At pension rate	40	60
At Federal rate	36	64

[1] Before adjusting for inflation.

[2] After adjusting for inflation.

[3] Interest rate used to discount taxes paid in retirement to the year of retirement.

Source: Sophie M. Korczk, Retirement Security and Tax Policy (Washington, D.C.: Employee Benefit Research Institute, forthcoming).

Pension benefits are not a "today" benefit but rather a long term proposition and the tax aspects can only be fairly viewed when placed in the same time-frame as the benefit itself. The table above certainly suggests that changing the taxability of pension related tax deferrals will not raise the number of dollars that is suggested by the 83% taxes lost number being used by our Treasury Department.

What are the savings aspects of pension coverage for participants? Pension coverage constitutes the major source of savings for more than half of current pension participants. While 52.2 million persons, or 56.4 percent of the labor force, had little or no savings of their own in 1979, 26.8 million, or more than half, were covered by employer pensions. Since these persons had incomes just over half the size of those with some savings, pensions appear to distribute wealth more equally than would be the case in their absence.

TABLE 6.—SAVINGS, PENSION COVERAGE, AND INCOME, 1979

Savings status [1]	Covered [2]		Not covered		Average annual income	
	Number (millions)	Percent	Number (millions)	Percent	Amount	Percent
No savings [3]	26.8	29.0	25.4	27.4	$7,672	56.4
Some savings	25.9	28.0	14.4	15.6	13,914	43.6
Total	52.7	57.0	39.8	43.0	11,193	100.0

[1] Persons are classified as having some savings or no savings according to whether or not they reported any asset income in the survey. Asset income includes interests, dividends, rents, and royalties.

[2] Coverage refers to employer plans only, both in the public and in the private sector, and does not include holders of IRA and Keogh accounts.

[3] Includes persons reporting negative asset income.

Source: Employee Benefit Research Institute calculations based on Bureau of the Census, Current Population Survey (May 1979).

These numbers become particularly significant when you compare them with the distribution of earnings and IRA participation. The people most served by pensions are least able or willing to utilize the IRA.

CUMULATIVE EARNINGS DISTRIBUTION: IRA AND SPOUSAL IRA PARTICIPATION FOR THE CIVILIAN LABOR FORCE AND THE ERISA WORK FORCE, MAY 1983

[Total Employees and Labor force in thousands, all else in percent]

Earnings	Employment distribution	IRA contribution distribution	Distribution among those eligible for spousal IRA	
			Contributes to IRA	Established spousal IRA
ERISA work force: Total employees [1]	52,136	11,204	2,189	1,378
Less than $5,000	1.86	1.11	0.88	1.30
Less than $10,000	16.21	8.86	4.18	3.09
Less than $15,000	39.46	23.52	13.77	9.39
Less than $20,000	59.54	41.07	28.63	21.99
Less than $25,000	76.48	57.58	43.61	38.34
Less than $30,000	85.89	70.96	57.81	50.31
Less than $50,000	97.13	91.87	83.66	79.05
Total earnings	100.00	100.00	100.00	100.00
Civilian labor force: Labor force [1]	87,067	14,481	2,905	1,630
Less than $5,000	13.71	5.81	3.91	3.55
Less than $10,000	31.94	15.60	9.81	6.12
Less than $15,000	54.81	30.17	20.9	12.48
Less than $20,000	70.48	46.51	34.27	25.04
Less than $35,000	82.75	61.32	49.05	41.41
Less than $40,000	89.44	72.75	61.41	52.57
Less than $50,000	97.68	91.95	85.00	79.78
Total earnings	100.00	100.00	100.00	100.00

[1] Excludes workers without reported earnings.

Source: Employee Benefits Research Institute, preliminary tabulations of May 1983 EBRI/HHS CPS pension supplement.

Employee benefits serve a number of purposes. Pensions, profit-sharing plans, and employee thrift plans provide for deferral of income and encourage private saving for retirement. Health benefits, disability income plans, life insurance, and supplemental unemployment benefits provide insurance protection against unanticipated, catastrophic events. Some programs provide for consumption; these include day care benefits and, sometimes, routine dental and vision care benefits. Many of these benefits, together with employee vacation time and rest periods, are intended to raise employee productivity, reduce time lost from work, and build positive employee relations.

Expanded employer pension and welfare plans over the past thirty years have significantly improved the income security of current workers and future retirees. Growth of employer group health insurance coverage among workers and their dependents has promoted wide access to health care throughout the nonelderly population. These achievements are, in part, a response to tax incentives.

The growth of employee benefits as a form of employee compensation has attracted increasing attention in recent years chiefly because of a concern that the growth of benefits occurs at the expense of growth in wage and salary income. Slower growth of wages and salaries, in turn, implies slower growth of the tax base. Erosion of the tax base affects the public sector's ability to finance government programs in general and the Social Security system in particular. In addition, growth of nontaxable benefits may generate an important redistribution of the tax burden across the population. These effects of growth in employee benefits, and in tax-exempt benefits in particular, merit careful attention.

For purposes of analysis, employee benefits can be classified into three categories:

Legally required benefits (including employer contributions to Social Security, unemployment insurance and workers' compensation insurance);

Discretionary benefits that are fully taxable (primarily payment for time not worked); and

Discretionary benefits that are tax-favored (including employer contributions to pension and health insurance plans).

Discretionary employer contributions to tax-favored benefits (those that are not taxed as current income to the employee) can be further subdivided into two groups: benefits on which taxes are deferred and benefits that are tax exempt.

Tax-deferred benefits primarily include employer contributions to retirement income and capital accumulation plans. Taxation of these benefits is deferred until the employee withdraws funds from the plan.

Tax-exempt benefits include employer contributions to group health insurance and a variety of smaller benefits that include dental insurance, child care, merchandise discounts, and employer-provided meals.

Discretionary tax-favored employee benefits represent about 28 percent of all employee benefits and 9 percent of wages and salaries. Since 1950, tax-favored employee benefits as a share of compensation (table 8) have grown at an average annual rate of 4.4 percent, compared to somewhat slower growth of legally required benefits and of taxable discretionary benefits.

TABLE 8.—AVERAGE ANNUAL GROWTH RATES OF MAJOR EMPLOYEE BENEFITS AS A SHARE OF TOTAL COMPENSATION, 1950–83

[In percent]

Employee benefit	Average annual rate of growth		
	1950–80	1970–80	1980–83
Total benefits	2.5	1.8	2.2
Legally required benefits	2.6	2.1	3.0
Discretionary fully taxable benefits [1]	1.4	1.2	1.2
Discretionary tax-favored benefits	4.4	3.0	3.0
Government pensions	2.1	0	0
Private pensions and profit-sharing	4.9	4.5	1.9
Group health	6.3	4.5	6.1
Group life	2.3	−2.2	0

[1] Vacation time and other time not worked. Calculations based on interpolations from Chamber of Commerce data for 1980 and 1982.

Source: EBRI calculations based on U.S. Chamber of Commerce, Employee Benefits 1982 (Washington, DC: Chamber of Commerce, 1983).

Employer contributions to group health insurance are the fastest growing component of employee benefits. The expansion of worker and dependents' coverage under employer group plans, the enhancement of benefits under these plans, and persistent high inflation in health care costs have all contributed to the growth of employer contributions to health insurance as a share of compensation. Between 1950 and 1980, employer health insurance contributions as a percent of total compensation have risen at an average annual rate of 6.3 percent. Reflecting continued high inflation in health care costs since 1980, employer contributions to health insurance have continued to grow at an average annual rate of 6.1 percent more than the growth of compensation.

Failure to distinguish among the growth of legally required employer payments, fully taxable employee benefits, tax-deferred benefits, and tax-exempt benefits has greatly distorted the perception of the tax-base erosion that can be attributed to tax-favored and tax-exempt benefits. This common misperception was highlighted by Secretary of the Treasury Donald Regan; his May 22, 1983, statement to ABC News included the following comment:

"I think that when you look at the way our pension systems, our medical systems and the like are . . . running at full throttle, and are increasing year after year, that sooner or later they're going to have to be slowed down or else we'll never get these deficits under control."

The size of tax-favored benefits as a proportion of wages and salaries, however, is much smaller than such statements suggest. Table 9 summarizes the distribution of discretionary tax-favored benefits by tax-deferred and tax-exempt status. In 1982, tax-deferred benefits constituted about 4.5 percent of wages and salaries; tax-exempt benefits constituted 4.6 percent.

TABLE 9.—DISCRETIONARY TAX-FAVORED EMPLOYEE BENEFITS BY SPECIFIC TAX TREATMENT, 1982

Tax status/benefit group	Employer contributions as a percentage of wages and salaries	Employer contributions as a percentage of all benefits	Employer contributions as a percentage of tax-favored benefits
All tax-favored benefits	9.0	27.7	100.0
Tax-deferred benefits	4.5	13.8	49.5
Pension and profit-sharing plans [1]	4.0	12.3	44.0
Short- and long-term disability insurance [2]	.3	.9	3.3
Other tax-deferred benefits [3]	.2	.6	2.2
Tax-exempt benefits	4.6	14.2	50.5
Contributions to group health and life insurance [4]	4.1	12.6	45.1
Other tax-exempt benefits [5]	.5	1.5	5.5

[1] Includes EBRI estimate of employer contributions to profit-sharing plans based on Chamber of Commerce figures.

[2] EBRI estimate based on Chamber of Commerce figures.

[3] Includes EBRI estimate of employer contributions to employee thrift plans based on Chamber of Commerce figures.

[4] Estimate includes fully taxable employer payments for life insurance in excess of $50,000.

[5] EBRI estimate of discounts on merchandise, meals furnished by company, payments for vision care and prescription drugs, and moving expenses, based on Chamber of Commerce figures.

Note.—Figures may not add to total because of rounding.

Source: EBRI tabulations of U.S. Chamber of Commerce estimates in Employee Benefits 1982 (Washington, D.C.: U.S. Chamber of Commerce, 1983). pp. 11 and 28.

Private retirement program tax expenditures form the single largest category of tax expenditures in the federal budget. They arise from the deferral of taxes paid on: (1) pension and retirement saving contributions; and (2) earnings on these contributions. Tax deferral of pension and retirement saving contributions represents deferral of current revenue; taxes are paid on withdrawals from the funds after the worker retires. In a lifetime context, however, gross federal revenue losses are significantly lower than current revenue deferrals. As much as 75 percent of the real (i.e., inflation-adjusted) value of taxes deferred during pension participants' working careers is ultimately repaid in retirement income taxes.

(Sophie Korczyk, Retirement Security and Tax Policy (Washington, D.C.: Employee Benefit Research Institute, forthcoming). These simulation results are consistent with calculations for hypothetical workers reported by Richard A. Ippolito, "Public Policy Towards Private Pensions" Contemporary Policy Issues, 3 (April 1983): 53–76.)

TABLE 10.—EMPLOYER BENEFIT TAX EXPENDITURES IN THE ADMINISTRATION'S BUDGET BY BUDGET FUNCTION, FISCAL YEARS 1983–1985 [1]

[In millions of dollars]

Provision	1983	1984	1985
Commerce and housing credit: Exclusion of interest on life insurance savings	$4,335	$4,720	$5,180
Education, Training, Employment, and Social Services:			
Employer educational assistance	40	20	
Exclusion of employer provided child care	20	40	70
Exclusion of employee meals and lodging (other than military)	680	725	795
Exclusion of contributions to prepaid legal services plans	40	40	45
Investment credit for ESOP's	1,250	1,375	1,875
Health: Exclusion of employer contributions for medical insurance premiums and medical care	15,270	17,625	20,165
Social Security and Medicare:			
Exclusion of Social Security benefits:			
OASI benefits for retired workers	14,035	13,895	12,975
Benefits for dependents and survivors	3,775	3,755	3,765
Disability insurance benefits	1,310	1,225	1,105
Income security:			
Exclusion of railroad retirement system benefits	780	615	450
Exclusion of workman's compensation benefits	1,885	2,020	2,215
Exclusion of special benefits for disabled coal miners	160	155	155
Exclusion of untaxed unemployment insurance benefits	2,960	2,305	1,800
Exclusion of disability pay	120	75	
Net exclusion of pension contributions and earnings:			
Employer plans	46,585	50,535	56,340
Individual Retirement Accounts	8,855	9,190	9,840
Keoghs	1,460	1,475	1,530
Exclusion of other employee benefits:			
Premiums on group term life insurance	2,040	2,170	2,380
Premiums on accident and disability insurance	120	120	125
Income of trusts to finance supplementary unemployment benefits	20	20	20
Veterans benefits and services:			
Exclusion of veterans disability compensation	1,815	1,810	1,855
Exclusion of veterans pensions	345	335	340
Total	107,950	114,295	123,125

[1] Budget functions are groups of federal programs or activities that address a common national need. There are 18 budget functions.

Source: Special Analysis G. Budget of the Government of the United States Government, fiscal year 1985.

Employer contributions to group health insurance are the fourth largest tax expenditure in the 1985 budget. These contributions are exempt from Social Security, corporate income and individual income taxation.

Tax expenditure estimates are a poor guide for setting either federal tax policy or federal retirement or health policy. Nevertheless, the high tax expenditure estimates for pension and group health insurance plans continue to attract public attention and critical appraisal of these plans' tax-favored status. Measurement of current versus lifetime tax revenue losses, however, is only part of the task of evaluating tax preferences for employer pension contributions, retirement saving, and employer-sponsored health insurance. The benefits to society that derive from tax preferences for these plans must also be appraised. Tax laws favoring employer retirement and health insurance plans were enacted under the premise that broad coverage of workers and their dependents under these plans is desirable social policy.

Worker participation in tax-favored employee benefits

Between 1950 and 1979, the rate of worker participation in employer pensions grew by 23 percent; in absolute numbers, employee pension participation rose by 263 percent. Econometric estimates suggest that, since 1960, 20 to 30 percent of the increase in employer pension contributions as a share of compensation can be attributed to favorable tax incentives and the growth of real marginal tax rates.

The tax deferral of employer pension contributions and individual retirement saving provides important incentives for employers and workers to provide for retirement income. The increasing importance of pensions as a source of income projected among future retirees is the direct result of past growth in pension plan participation among workers. The projected rate of pension recipiency among today's young workers (ages twenty-five to thirty-four) is nearly twice that of workers who are retiring today (see table 11).

TABLE 11.—ESTIMATED PERCENTAGES OF FAMILIES RECEIVING PENSION BENEFITS AT AGE 65, AND AVERAGE REAL BENEFITS, BY CURRENT AGE AND MARITAL STATUS

Cohort age in 1979	All families		Married couples		Single persons	
	Percentage to receive benefit	Average amount of benefit [1]	Percentage to receive benefit	Average amount of benefit [1]	Percentage to receive benefit	Average amount of benefit [1]
25 to 34	71	$12,417	75	$14,541	65	$8,701
35 to 44	65	11,190	67	12,563	60	8,823
45 to 54	52	8,656	58	9,621	41	6,496
55 to 64	37	5,315	44	5,548	26	4,718

[1] Real dollars are calculated using 1982 as the base year.

Source: Social Security: Perspectives on Preserving the System (Washington, D.C.: Employee Benefit Research Institute, 1982), p. 90.

Partly because of tax incentives, participation in employer pension and health insurance plans is high. In 1979, 48 percent of the total work force participated in an employer pension plan; 74 percent were covered by an employer group health insurance plan. Among full-time, full-year workers, rates of coverage are much higher. In 1979, more than 74 percent of full-time full-year workers participated in an employer pension plan, and 89 percent were covered by an employer health plan (Schieber and George, Coverage and Benefit Entitlement, pp. 38 and 54; and Chollet, Employer-Provided Health Benefits. Pension coverage rates for full-time full-year workers include only nonagricultural workers, age twenty-five to sixty-four, with one year of service and working more than half-time. Health insurance coverage rates include all full-time nonagricultural workers who worked fifty weeks or more during 1979). Participation in tax-favored individual retirement saving plans is more modest. In 1982, 13 percent of all households that filed a federal income tax return reported participation in an individual retirement account (IRA). (U.S. Department of the Treasury, Internal Revenue Service, "Selected Statistical Series, 1970–1983," Statistics of Income (SOI) Bulletin, 3 (Winter 1983–84): 62).

Employee benefits are widely distributed among workers and their families at all income levels. Reflecting the concentration of workers at low and middle incomes, most workers who participate in employer pension and health insurance plans are low or middle income workers. In 1979, 75 percent of all workers covered by an employer pension plan under ERISA standards, and 80 percent of all workers covered by an employer group health plan, earned less than $20,000 (see table 12).

TABLE 12.—DISTRIBUTION OF EMPLOYEES WITH PENSION AND HEALTH COVERAGE BY EARNINGS, 1979

[Amounts in millions]

Earnings	Employees with pension coverage		Employees with health coverage	
	Total	Percent	Total	Percent
Less than $20,000	27.8	75.3	58.3	79.8
$20,000 to $49,000	8.7	23.7	13.9	19.1
$50,000 and over	.3	.9	.8	1.1
Total [1]	36.9	100.0	73.0	100.0

[1] Figures may not sum to totals because of rounding.

Sources: Pension distribution based on Retirement Income Opportunities in an Aging America: Coverage and Benefit Entitlement (Washington, D.C.: Employee Benefit Research Institute, 1981). Health distribution from EBRI tabulation of the May 1980 Current Population Survey (U.S. Department of Commerce, Bureau of the Census).

The growth of new tax-favored employee benefits has alarmed those who see the emergence of these benefits simply as further erosion of the tax base. In fact, employers often have independent motivations for setting up these plans. The growth of new benefits, in particular Section 401(k) salary reduction plans, generally represents an effort by employers to contain the cost of tax-favored employee benefits.

Rising employer pension costs have prompted several innovations in the design of retirement income plans. Section 401(k) plans, authorized by the Revenue Act of 1978, have become an increasingly popular tool for controlling employer pension costs. Employees are able to supplement employer contributions to a Section 401(k) plan with tax-deferred contributions of their own. This allows employers to contain their retirement plan costs. In general, Section 401(k) plans probably represent a net reduction in employer pension contributions relative to the level that would be required to ensure adequate retirement income with lower employee retirement saving.

Section 401(k) plans also reduce the employer's projected cost of indexing retirement benefits. Although pension benefit increases are seldom automatic, most employers provide *ad hoc* cost-of-living adjustments for current retirees. Under current law, sponsors of defined-benefit pension plans cannot reserve funds against future *ad hoc* cost-of-living increases, even in cases where the plan has a clear history of providing those increases. *Ad hoc* increases, therefore, are funded from current contributions, or offset against actuarial gains, or added to the plan's unfunded liability.

Section 401(k) plans—and other defined contribution plans—represent a way to provide employees with some inflation protection in retirement, at a substantially lower cost to employers. Defined contribution plans are automatically indexed, since the asset value of the plan generally rises with inflation. Inflation reserves, therefore, accumulate automatically.

Section 401(k) plans also meet the demand for retirement income security among mobile workers and workers with intermittent labor force participation. Employee contributions to Section 401(k) plans are, by law, fully and immediately vested. Short-tenure workers, therefore, may be better served by 401(k) plans than by more traditional plans. These workers, and workers with intermittent labor force participation, are protected because they can "roll over" the accumulated contributions and earnings of the plan into a tax-deferred individual retirement account. As a result, Section 401(k) plans may particularly benefit young workers with high labor-force mobility and women who may leave the labor force for protracted periods.

Many observers of the emerging changes in employee benefit plans have claimed that the development of new forms of employee benefits merely represents further tax-base erosion. These claims, however, have often been made with little or no supporting evidence. There are several reasons to believe that the growth of nontraditional benefits, in particular Section 401(k) plans, may actually reduce further erosion of the payroll and individual income tax bases.

While employer contributions to traditional pension plans are entirely tax-deferred, employee contributions to Section 401(k) plans are taxable by Social Security. Employers have favored Section 401(k) plans as a means of reducing the level of contributions they might have to make if they offered only a traditional pension plan. If the growth of Section 401(k) plans does, in fact, substitute for the growth of more traditional pension benefits, they would represent an addition to the current payroll tax base.

In conclusion, the tax laws favoring specific employer retirement and health insurance plans were enacted under the premise that extensive coverage of workers and their dependents under these plans is desirable social policy. The growth of worker coverage by pensions and health insurance since 1950, has been strongly encouraged by the tax advantages accorded these plans, and by the growth of real marginal tax rates.

Employee benefits are widely distributed among workers and their families at all income levels. Like the labor force as a whole, most workers participating in employer pension and health insurance plans are low and middle income workers. In 1979, more than 75 percent of all workers covered by an employer pension plan under ERISA standards, and 80 percent of all workers covered by an employer group health plan, earned less than $20,000. Contrary to the perceptions of many, there is no evidence that tax preferences for employee benefits favor only highly paid workers.

The historic growth of private pension plan participation among workers, and the current growth of worker participation in Section 401(k) plans and IRAs represent private saving for retirement income. Considering the increasing cost of Social Security and the projected decline in the ratio of workers to retirees, private saving for adequate income replacement in retirement has emerged as a necessary and desirable public goal.

The emergence of nontraditional benefits warrants careful and balanced scrutiny. These benefits generally serve to balance the interests of employers seeking to contain benefits costs and the interests of employees, who demand a more diversified package of benefits than ever before. The new forms of employee benefits may serve best those workers whose needs are least adequately met by more traditional benefits—younger workers and employed parents. Further, the growth of nontraditional benefits may actually contribute to the payroll and income tax bases, to the extent that the new employee benefit forms substitute for traditional tax-exempt or fully tax-deferred benefits.

A final note: "Tax deductible" does not mean dollar-for-dollar offset. Even in the highest bracket, half of every deductible dollar spent could have been retained by paying the tax on it rather than spending it.

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